Varazdin Development and Entrepreneurship Agency
in cooperation with:

- **Faculty of Law, University of Split**
- **University of Split**
- **Faculty of Law, University of Sarajevo**
- **University North**
- **Faculty of Management University of Warsaw**

Economic and Social Development

22nd International Scientific Conference on Economic and Social Development – "The Legal Challenges of Modern World"

Editors:
Zeljko Radic, Ante Roncevic, Li Yongqiang

Book of Proceedings

ISSN 1849-7535

Split, 29-30 June 2017

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

Editors:
Zeljko Radic, Ante Roncevic, Li Yongqiang

Economic and Social Development

22nd International Scientific Conference on Economic and Social Development –
"The Legal Challenges of Modern World"

Book of Proceedings

Split, 29-30 June 2017

Title ■ Economic and Social Development (Book of Proceedings), 22nd International Scientific Conference on Economic and Social Development – "The Legal Challenges of Modern World"

Editors ■ Zeljko Radic, Ante Roncevic, Li Yongqiang

Publishing Editor ■ Domagoj Cingula

Publisher ■ **Design** ■ **Print** ■ Varazdin Development and Entrepreneurship Agency, Varazdin, Croatia
Faculty of Law, University of Split
University of Split
Faculty of Law, University of Sarajevo, Bosnia and Herzegovina
University North, Koprivnica, Croatia
Faculty of Management University of Warsaw, Warsaw, Poland

Copies ■ Online Edition

ISSN 1849-7535

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

Our Books are indexed and abstracted by ProQuest, EconBIZ, WoS (CPCI) and AEA (EconLit) databases and available for download in a PDF format from the Economic and Social Development Conference website:
http://www.esd-conference.com

CONTENTS

THE LEGAL CHALLENGES OF MODERN WORLD

ECONOMIC AND SOCIAL DEVELOPMENT

The Legal Challenges of Modern World

LEGAL ASPECTS OF ENSURING TAX STABILITY

Aleksandra Tychmanska
University of Warsaw, Poland
aleksandra.tychmanska@gmail.com

ABSTRACT
This paper considers which elements are crucial for building stable tax system in modern globalised world. To answer this question author presents various contexts in which should we discuss design of tax system: processes of globalization and their impact on tax law, initiatives at international level of OECD and their significance for domestic level, the role of European Union and their initiatives for tax matters of its member states, function of taxes and the main tax principles. These contexts provide the conclusion in which author conceptualizes the frames and methods of modern tax system design.
Keywords: *tax certainty, tax system, tax law, tax design*

1. INTRODUCTION

Taxes are the main source of revenue for governments, so it is essential to create stable and efficient tax system. Also taxation is one of an array of interrelated factors that motivates people's economic decisions (Hall, 1994, p. 5). It cannot be said how strongly international real investment will react to specific changes in tax policies, but tax policy is important factor in providing friendly environment for investments (Griffith, Hines, Sorensen, 2010, p. 930). Also the largest source of policy uncertainty are fiscal matters, especially tax policy (Baker, Bloom, Davis, 2016). The way in which tax system is designed matters enormously to economic welfare (Mirrlees, 2011, p. 1). This paper discusses various contexts which follows to conclusion how to design stable tax system in modern globalised world.

2. TAXES IN GLOBALISED WORLD

To analyze tax design we have to identify the ground on which taxes exist. Globalization carries profound implications for tax systems. Institutional barriers to the movement of goods, services and capital have relevantly decreased (Griffith R., Hines J., Sorensen P. B., 2010, p. 915). It is much easier to move capital and taxable profits between jurisdictions. There is also much bigger difficulty in defining the localization where assets and activities, which generate income, are. In globalised environment tax system of one country cannot be considered in an isolation. As an example: when some countries try to attract capital, profits and corporations by introducing specific regimes mainly targeted to cross-border investment, and on the other side is a group of countries which is trying to protect their domestic tax revenues in the process of tax competition by introducing specific provisions, all of these generates tax uncertainty (Zangari, Caiumi, Hemmelgarn, 2015, p. 2-3) and is a source of even more grievous complexity of tax system . This example shows that the activity of one country may strongly affect at the tax system of another country, the tax system which in isolation of tax systems of another states can be seen as a fair, stable and well-design. Farther globalised world creates opportunities for countries to attract capital by favorable tax regimes leading to aggressive tax competition within countries. These remarks show that in globalised world countries to successfully manage their tax system need to cooperate with other countries to fairy distribute revenue of taxes. Designing their domestic tax rules, sovereign countries may not sufficiency take into account the effect of others countries rules (OECD, 2013, p. 9). These times taxes are not only domestic matter, but also very important international issue. States understand today that many issues that were traditionally

considered as pertaining to domestic jurisprudence and policy have now risen to the international level, and need to be influenced there (Matias, 2008, p. 5).
Matter of taxes is one of this kind of issues. At the international level crucial role in cooperation between countries in tax field plays OECD and European Union at the regional, European level. On the other hand the extent to which national governments can enact reforms is constrained: by being member of UE country is bound by a Treaty of Rome and the rulings of the European Court of Justice and a large network of tax treaties fostered by the OECD (Griffith, Hines, Sorensen, p. 917). Today's many times a state finds itself in a position where it must enter into a new international agreement or accede to an existing one, if it wishes to stay a viable actor in the international community and globalized economy. We observe the process of harmonization of standards and mechanisms for enforcement in topics previously considered as domestic. (Matias, 2008, p. 6, 9). Today's world domestic tax law is being strongly affected by international law and probably this process will deepen.

3. INTERNATIONAL LEVEL, EU LEVEL – THE ROLE, INITIATIVES IN BUILDING CERTAIN TAX SYSTEM

Organization for Economic Co-operation and Development (OECD) is an intergovernmental economic organization founded in 1960. It includes 34 member countries; also collaborate with more than 100 other economies, many of which participate in its committees and adhere to its instruments. In order to join the OECD a state must be willing to adhere to the basic principles of the Organization: open market economy and a democratic political system. Also, all joining states must commit to and prove they can meet numerous conditions of the OECD (Matias, 2008, p. 11). The aim of OECD is to help countries develop policies together to promote economic growth and healthy labor markets, boost investment and trade, support sustainable development, raise living standards and improve the functioning of markets (OECD, 2016). OECD has huge role in developing new solutions in tax matters at the international level and cooperation between states. Most of the BTT signed by countries conform to the model treaties proposed by the OECD or the United Nations (Blonigen, Oldenski, Sly, p. 5), but OECD leads also many others, worthwhile initiatives. Of latest initiatives very important and significant initiative of OECD is Action Plan on Base Erosion and Profit Shifting proposed in 2013. It introduces 15 actions which should be undertaken to ensure the coherence of corporate income taxation at the international level including strengthening CFC rules, developing model treaty provisions and recommendations regarding the design of domestic rules to neutralize the effect of hybrid instruments and entities or assuring that transfer pricing outcomes are in line with value creation (OECD, 2013, p. 13-24). Also the issue of tax uncertainty is important subject for OECD; it became one of the taxation issues of discussion at the G20 during the Chinese Presidency, taken over by the German Presidency in 2017. OECD published report which discusses the issue of tax certainty „Tax certainty. IMF/OECD Report for the G20 Finance Ministers". Activity of OECD should be seen as a very positive input in building tax certainty and stability at the international level. To remind in globalised environment tax system of one country cannot be considered in isolation, organizations like OECD provides very important field for cooperation between states on tax matters. European Union is a crucial entity which influences domestic tax orders of its member states.

There are many initiatives on EU level for tax certainty. In the field of directive taxation there have been in recent time some important initiatives in ,,fair corporate taxation"[1]:

1) In tax transparency: in March 2015 Commission presented Tax Transparency Package; a key element of this proposal was to introduce the automatic exchange of information between Member States on their tax rulings. The Council adopted the proposed directive in December 2015 (COUNCIL DIRECTIVE (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation).

2) In effective taxation: the main proposals in this field are The Common Consolidated Corporate Tax Base (Proposal for a COUNCIL DIRECTIVE on a Common Corporate Tax Base, 2016) through which companies will for the first time have a single rulebook for calculating their taxable profits throughout the EU. It will be mandatory for large multinational groups.

   Another important initiative is Anti Tax Avoidance Package. The most relevant result of this package is The Anti Tax Avoidance Directive which proposes six legally-binding anti-abuse measures, which all Member States should apply against common forms of aggressive tax planning. Also import ant part of this package are Recommendation on Tax Treaties which advise member states how to reinforce their tax treaties against abuse by aggressive tax planners, in an EU-law compliant way and revision of the Administrative Cooperation Directive, which proposes country-by-country reporting between member states' tax authorities on key tax-related information on multinationals operating in the EU.

3) In creating better business environment: Proposal for a COUNCIL DIRECTIVE on Double Taxation Dispute Resolution Mechanisms in the European Union of October 2016 which lays down rules to resolve disputes between member states on how to eliminate double taxation of income from business and the rights of taxpayers in this context.

Another important point is that EU respects activity of OECD. As an example in Communication from the Commission to the European Parliament and The Council about A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, Commission emphasize: ,,The EU can build on international reforms, and it must consider how best to integrate the results of the BEPS project at EU level". This kind of action should be seen as a very positive step in entrenching OECD international standards. Another point are actions of EU in the field of indirect taxation which also are main element of recent Commission initiatives. There are a lots of problems with current VAT system which is very complex, complicated and open to fraud. The current VAT rules urgently need to be updated so they can better support the single market, facilitate cross-border trade and keep pace with today's digital and mobile economy. Current crucial initiative is an Action Plan on VAT adopted by the Commission in 7 April 2016. This action plan sets out the pathway to the creation of a single EU VAT area. The Commission will present in 2017 a legislative proposal for a definitive VAT system for cross-border trade. This definitive VAT system will

[1] See Commission's agenda for fairer, simpler and more effective corporate taxation in the EU: http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/anti_tax_avoidance/timeline_without_logo.png.

be based on the principle of taxation in the country of destination of the goods. Another interesting initiative of Action Plan on VAT is SME VAT Package which is supposed to be presented by the end of 2017. The point of this package is to create an environment for small and medium-sized enterprises (SME), environment which is conductive to growth and favorable to cross-border trade, because in this moment SME bear proportionally higher VAT compliance costs than large businesses due to complexity and fragmentaration of the EU VAT system. (COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE on an action plan on VAT Towards a single EU VAT area - Time to decide).
To sum up: tax policy, traditionally seen as a domestic matter has become also important international matter. Countries are being affected to a greater extent by initiatives on tax law by international organizations (mainly OECD) and in perspective of EU member states, by initiatives promoted by EU. These kind of activities are increasing and are leading to assimilation of tax systems of states.

4. MAIN CAUSES OF TAX UNCERTAINTY

To summarize the main sources of tax uncertainty we will use the data from IMF and OECD report (IMF/OECD 2017, p. 16-24). It groups into six categories the main sources of tax uncertainty:

1) POLICY DESIGN AND LEGISLATIVE UNCERTAINTY

   The main problems are:
   - unexpected frequent changes in tax law;
   - regulations and guidance, temporary provisions when their expiry date is either unclear or not credible;
   - unclear, poorly drafted law and ineffective tax law making and monitoring processes.

2) POLICY IMPLEMENTATION AND ADMINISTRATIVE UNCERTAINTY

   The main problems are:
   - ineffective and unpredictable implementation where there is a gap between the tax legislation and its application or when application of tax rules by the tax authority is discretionary and incoherent;
   - a poor general relationship between business and the tax authority.

3) UNCERTAINTY AROUND DISPUTE RESOLUTION MECHANISM

   A lack of clear and timely dispute resolution mechanisms and processes is likely to generate uncertainty. Issues can arise also when such procedures are in place, but dispute resolution process takes a lot of time or is costly.

4) UNCERTAINTY ARISING FROM CHANGES IN BUSINESS AND TECHNOLOGY

   Business models are changing rapidly and application of existing tax rules to new business can be difficult and uncertain.

5) TAXPAYERS CONDUCT CAN CONTRIBUTE TO UNCERTAINTY

The issue is that some taxpayers will test the limits and interpretation of tax provisions and also when taxpayer does not have a clearly articulated approach towards its overall tax planning strategy or clearly defined understanding of the levels of tax risk it is willing to accept.

6) INTERNATIONAL ASPECTS OF UNCERTAINTY

Uncertainty can arise for both businesses and tax authorities: tax authorities are facing an additional level of engagement and co-operation with the tax administration of other sovereign countries and businesses have to interact with different tax systems.

Another important dimension of tax uncertainty gives us a paper ,,Tax Uncertainty: Economic Evidence and Policy Responses" (Zangari, Caiumi, Hemmelgarn, 2015) which distinguishes:

1) DOMESTIC LEVEL

The uncertainty on domestic level occurs because of frequent changes of tax code, overall process of a tax reform, from the announcement and the preparation, to the implementation and the following fine-turning, information asymmetry between policy makers and taxpayers about changes in tax law

2) INTERNATIONAL LEVEL

The main cause of uncertainty in tax matters at international level is an existence of different tax systems that can lead to aggressive tax competition.

In summary, there are various aspects of tax uncertainty. It is very important to identify them and ideas to resolve them designing tax system; because of that there should be more surveys focused on this topic.

5. ROLE OF TAX PRINCIPLES IN ENSURING STABLE AND EFFICIENT TAX SYSTEM

There are many ideas to ensure the stable and effective tax system.
One of them is a group of initiatives which pay attention to principles of tax policy. Historically Adam Smith's tax maxims that are the set of guidelines that should characterize good and effective national tax system should be evoked (Smith, 1991, p. 498-500):

1) The subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to the revenue which they respectively enjoy under the protection of the state
2) The tax which each individual is bound to pay ought to be certain, and not arbitrary
3) Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it

4) Every tax ought to be so contrived as both to take out and to keep out of pockets as little as possible, over and above what it brings into the public treasury of the state

They provide the basics to tax design and are very important as a first step considering tax principles.

Nowadays commonly cited principles are (some of them are related):

1) Simplicity

   We can distinguish various levels of simplicity: simplification of the tax system or structure means reducing the number of taxes, leaving only those easier to pay and collect, simplification of the tax laws means drafting plain and understandable laws and reducing distortions and simplification of application of tax rules means communicating the tax rules directly and effectively to the appropriate sector (BGConsulting, 2013, p. 2). Simplicity of tax system is crucial for taxpayers, but it also should be remembered that desire to simplicity may lead to laws that are incomplete or vague, making the tax law hard to administer and comply with (OECD, 2017, p. 44). On the other hand complex tax system are conducing to tax avoidance and evasion (BGConsulting, 2013, p. 3). Tax system than should be as simple as possible, but also clear and coherent.

2) Neutrality

   It means that tax policy shouldn't favor one kind of activity or another (ITEP, 2012).

3) Stability

   This principle means that after simplifying tax system it must remain as stable as possible. Stability for investors means being able to predict a reasonable amount of taxes and compliance costs work. For tax administrations it means the effort and cost invested in educating and informing taxpayers about new tax laws and procedures is minimized, the costs of training staff are reduced as well as the costs of producing new tax forms, the costs of assessing taxes, of defending in tax appeals and of imposing sanctions -generally due to mistakes of taxpayers in understanding the new changes or the new tax law- are also reduced and that by reducing costs, efforts may be focused in detecting and punishing tax evasion and fraud ((BGConsulting, 2013, p. 4)

4) Equity and fairness

   It means that taxpayers in the same situation should be treated similarly. We distinguish: horizontal equity which describes two taxpayers with equal abilities to pay – they should pay the same amount of tax and vertical equity which means that the person with the greater ability to pay should pay more tax. How much more tax should be paid is a topic of political debate (PICPA). Measuring the equity of taxpayers is very problematic especially in progressive income tax when it has to considered which states of need are relevant, which should be tax relieved, etc. (Forte, 2010, p. 245).

5) Certainty

   The tax law should specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined (PICPA). The lack of certainty of tax law is very negative for taxpayers. ACCA (ACCA, 2009, p. 5) noticed that companies legitimate tax planning techniques can find themselves having to report to the

authorities or becoming the subject of onerous tax enquiries what is unacceptable for companies trying to plan their business activities.

6) Efficiency

It means that tax system should be efficient for governments in terms of their ability to secure the revenue due, prevent tax leakage and the development of black economy, but it should also be efficient for taxpayers in terms of complying with its requirements (Ibidem, p. 6)

Tax principles are very important considering design of tax system and should be widely known and favored. Governments discussing changes in tax system should seen tax principles as a ground for more detailed ideas.

6. FUCTION OF TAXES

The main purpose of taxes is to bring revenue for the country. Taxes are the most important source of revenue for government. Next revenue which gains government from taxes is to fulfill social needs. It is important to emphasize this crucial function of taxes - the tax system should be designed the way which is the most efficient for collection of revenue. In rational model of tax law fiscal function has a priority and any other functions has to be ancillary to fiscal function (Modzelewski, 2010, p. 24). It is very dangerous to look at the tax system in a way to encourage social behaviors. There are various ways in which it can be done. Government could try to encourage by tax law business decisions. But the success of tax incentives to attract foreign investment is doubtful. They are only a small part of country's appeal. They can even be seen as a wasteful giveaways, as foreign investors might have made the investment anyway (Michie, 2011, p. 206). Also it has to be said that markets normally allocate resources more effectively than government action (Minesota Center of Fiscal Excellence, p. 2). Another important point is that this kind of action can cause tax uncertainty at the international level leading to aggressive tax competition. This kind of act can be tempting, but it has to be emphasized that the tax system should be seen as just that – a system (Mirrlees, 2011, p. 2). The idea of this system is to collect revenue, not to change economical behaviors. A well-functioning tax system doesn't need special incentives and stimulated growth (OECD, 2017, p. 44).

7. CONCLUSION - DESIGN OF TAX SYSTEM

Knowing the current globalised ground on which taxes exist, the function and role of taxes, international and EU initiatives and their impact on tax matters, main causes of tax uncertainty and basic tax principles we can consider how to design stable and good tax system in today’s world. The main point is that designing the tax system all of the contexts described above should be considered. Crucial in designing tax system is to look at it as a whole. Also achieving the overall objectives of the tax system it is important to consider all taxes together as a system (Mirrles, 2011, p. 35). One of the most relevant causes of tax uncertainty are unexpected, frequent changes in tax law. Of course some changes in tax law are necessary to build good tax system in the long-run, but in practice many of changes are misguided and fragmentary and not considered through the design of a whole tax system. Also bad legislation impacts negatively both for taxpayers and tax administration. Issues related to tax administration are among the most important factors creating tax uncertainty for business. In particular bureaucracy and unpredictable and inconsistent treatment by the tax authority (OECD, 2017, p. 31). The leading sources of tax uncertainty seen by the tax administrations, is in tax policy design and legislation and dispute resolution: complexity in legislation, lengthy court procedures, unclear drafting and frequency of legislative changes

(Ibidem, p. 35). These gives a point that the first cause of tax uncertainty are problems of tax legislation. While the problems connected with acts of tax administration often are a result of problems with designing certain and coherent tax system. Many changes in tax law are being made as a result of prevention of effects which are a result of poorly drafted tax law. This kind of action is common and is a serious cause of destabilization and needless complication of a tax law. Discussing the problem of tax certainty we should emphasize the crucial role of good legislation. Weakness of institutional framework of tax policy, at the domestic and the international level, are the main drivers (Griffith, Hines, Sorensen, 2010, p. 2). I want to pay attention to the fact that changes in tax law should be very careful and reflected. Tax system is a very complicated structure and every new, misguided change makes this structure even more opaque. The problem is that aim of many changes in tax law is to simpler and get better tax system, but it fails because designers don't present holistic approach to tax system design. In this point there is a huge role of basic tax principles which organize approach to designing tax system. This process should be methodological and clearly defined tax principles are one of a key aspects in providing that. I think that we should see a tax system just as a tool which aims to collect revenue to fulfill social needs. Also the tool which is very hard to design and will be even more complicated because of increasing processes of globalization that generates new dangers for tax system; all the more creating it we should be focused on the main function of tax system and their objectives. Speaking of globalization this process should be seen as a ground on which modern tax systems supposed to be designed; this kind of approach taking globalization as a chance of development is necessary. The contemporary environment in which tax systems exists need a tight cooperation between states on tax matters. In this point we should expect more and more initiatives on OECD and European Union level. Tax law is no longer only a domestic matter, it becoming more and more an international issue. Last important point is a significance of reports and research on taxes, tax law and tax system. They provide a great piece of knowledge for designing tax system. Changes of tax system should be a result of extensive surveys and analysis. Definitely they cannot be a reason of political game. To emphasize, tax system should be seen as an efficient tool which aims to collect revenue. Also tax policy and legislation should be better scrutinized by the cooperation of government and tax profession (House of Commons Treasury Committee, 2011, p. 26). Drafting tax law should be considered as a part of a whole tax system. As an example we can conjure up draft paper of New Zealand Treasury which in details discusses the role of tax in maintaining a sustainable fiscal position (New Zealand Treasury, 2013). This report provides comprehensive look at the domestic tax system, evokes many economical analysis and discusses individual aspects of tax law referring it to the whole tax system. This kind of approach when changing tax law is crucial for building good tax system. There is also a huge value of reports like that of IMF and OECD on tax certainty (IMF/OECD, 2017) and generally analyses of tax matters at international level. In summary, the aim of this paper was to describe the most important backgrounds which should be considered in the process of designing tax system. The holistic approach to design tax system and consciousness of its objectives are necessary. Tax system is a very complicated structure so designing it properly is not an easy task, but still very important for welfare of the state and taxpayers. In conclusion the role of research on tax system should be emphasized. Governments designing its tax systems should be very careful and make use of scientific analysis on tax matters.

LITERATURE

1. Auerbach A. J., 2006, Why have Corporate Tax Revenues Declined? Another Look, http://eml.berkeley.edu/~auerbach/AJA_CESifo_revised.pdf

2. Avis W. R., 2016, Linkages between taxation and stability, http://www.gsdrc.org/wp-content/uploads/2016/03/HDR1346.pdf
3. Baker S. R., Bloom N., Davis S. J., 2016, Measuring economic policy uncetainty, The Quarterly Journal of economics Vol. 131
4. Bell D., Tax design, http://localtaxcommission.scot/wp-content/uploads/Fundamentals-of-tax-design.pdf
5. BGConsulting, 2013, Tax simplicity and stability: atractive to countries and investors, http://www.bg-consulting.com/docs/tax_simplicity.pdf
6. Blonigen B. A., Oldenski L., Sly N., 2014, The differential effects of bilateral tax treaties, American Economic Journal: Economic Policy 2014, 6(2): 1–18
7. European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Comittee, On an action plan on VAT. Towards a single EU VAT area – Time to decide, Brussels 2016
8. European Commission, Commission Staff working document on the implementation of the definitive VAT regime for intra-EU trade, Brussels 2014
9. European Commission, Communication from the Commission to the European Parliament and the Council. A Fair Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, Brussels 2015
10. Forte F., Principles of Public Economics. A Public Choice Approach, Cheltenham 2010
11. Griffith R., Hines J., Sorensen P. B., International Capital Taxation, Dimensions of Tax Design, Mirrlees J., New York 2010
12. Hall A. P., 1994, The cost of unstable tax laws, Tax Foundation, Special report, No. 41
13. House of Commons Treasury Comittee, 2011, Principles of tax policy, https://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/753/753.pdf
14. IMF/OECD, 2017, Tax certainty. IMF/OECD Report for the G20 Finance Ministers, https://www.oecd.org/tax/tax-policy/tax-certainty-report-oecd-imf-report-g20-finance-ministers-march-2017.pdf
15. Institute on Taxation and Economic Policy, 2012, Tax principles: Building Blocks of a Sound Tax System, https://ieanea.org/wp-content/uploads/2012/02/Tax_principles.pdf
16. Matias S., 2008, Globalisation, international level and the state, Keynote Speech On October 17, 2008 at the Georgetown University Law Center's event on Globalization, http://www.justice.gov.il/Units/InternationalAgreements/Publications/Variance/SMatiasGolbalizationGeorgetownKeynoteSpeech08.pdf
17. Minesota Center of Fiscal Excellence, Taxing Decisions Matter: A Guide to Good Tax Policy, https://www.fiscalexcellence.org/our-studies/tax-policy-primer.pdf
18. Michie J., The Handbook of Globalisation, Second Edition, Cheltenham 2011
19. Mirrlees J., 2011, Tax By Design, New York
20. Modzelewski W., 2010, Wstęp do nauki polskiego prawa podatkowego, Warsaw
21. New Zealand Treasury, 2013, The Role of Tax in Maintaining a Sustainable Fiscal Position, http://www.treasury.govt.nz/government/longterm/externalpanel/pdfs/ltfep-s3-02.pdf
22. OECD, 2013, Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en
23. OECD, 1998, Harmful Tax Competition: An Emerging Global Issue, Paris
24. OECD, 2016, Secretary-General's Report to Ministers, http://www.keepeek.com/Digital-Asset-Management/oecd/economics/secretary-general-s-report-to-ministers-2016_sg_report-2016-en#.WRtDpIjyjIU
25. OECD, 2010, Tax Policy Reform and Economic Growth, OECD Publishing, http://dx.doi.org/10.1787/9789264091085-1-en
26. Smith A., Wealth of Nations, New York 1991

27. Pennsylvania Institute of Certified Public Accountants (PICPA), Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals, https://www.picpa.org/docs/site/advocacydoc/Legislative-Update/picpa-guiding-principles-of-good-tax-policy.pdf
28. The Association of Chartered Certified Accountants, 2009, Tax principles: From Adam Smith to Barack Obama, https://www.nctbpu.org.ua/pdf/analytics/Tax_Principles.pdf
29. United Nations, 2012, Committee of Experts on International Cooperation in Tax Matters Report on the seventh session, New York
30. Zangari E., Caiumi A., Hemmelgarn T, 2015, European Comission, Taxation papers. Tax uncertainty: Economic Evidence and Policy Response, European Union

THE CHILD'S RIGHT TO A CLEAN ENVIRONMENT

Ana Radina
Faculty of Law Split, Croatia
ana.radina@pravst.hr

ABSTRACT

Although the Convention on the Rights of the Child does not explicitly guarantee the child's right to a clean environment, it contains several provisions closely related to the issue of environmental protection, above all the child's right to life, survival and development, the right to the highest attainable standard of health, and the right to an adequate standard of living. A clean and healthy environment is a necessary precondition for the realisation of the said rights as well as the key determinant in the effective implementation of the Convention as a whole. The Convention is in force for nearly three decades now and it has been almost 25 years since the World Bank has expressly stated that investing in children's health is essential for ensuring human and economic development. Nevertheless, despite the global awareness of the destructive impact of environmental degradation on the children's lives and, by default, on the future of the humanity, we are facing the estimated 1.7 million children under five years of age dying each year due to environmental hazards. It seems both appropriate to reconsider the demands and challenges regarding the child's right to a clean environment that can be found in the Convention on the Rights of the Child, as well as their implications for governments. In the author's opinion, explicit recognition of the child's right to a clean environment should be made on a global level.

Keywords*: Child, Child's Right, Clean Environment, Health*

1. INTRODUCTION

Theoretical debates about the existence, grounds, and future of the human right to a clean and/or healthy environment have been going on for some time now and include, *inter alia*, suggestions of the human right to environment as an independent right emerging in international customary law (see, for example: Anton, Shelton, 2011; Boyle, 2012; Fitzmaurice, 1999; Francioni, 2010; Hajjar Leib, 2010; Lewis, 2012). None of the existing international human rights treaties recognise such a right as independent from other human rights but it is widely accepted that the enjoyment of fundamental human rights such as the right to life and health is preconditioned and strongly influenced by environmental factors. The problem with constructing the right of the child to a clean environment is part of a broader problem of the right to a clean environment in general. In this respect, several fundamental issues are still unresolved, including the very question of the existence of such a right and, assuming that there is such a right, whether it is the "right to an environment", the right to a "healthy", "safe" or "clean" environment. Notwithstanding the difficulties, determining whether, and to what extent, this right exists is very significant and practical since justiciability of a right depends on its substance (Fitzmaurice, 1999, 611-612). We find it justified to consider the environmental rights as the most universal form of human rights because they derive from the fundamental biological needs of all humans and transcend national borders as well as cultural differences and legal traditions (Collins, 2015, p. 222); we also believe that the time has come to finally recognise human right and, particularly, the right of the child to a clean environment. The latter would be justified vis-á-vis abundance of undeniable evidence of destructive influence of environmental degradation on children. Children's lives, health and development are seriously challenged by the environmental hazards they are exposed to, including air pollution, chemicals in food, water, soil, clothes or toys, lack of clean water, malnutrition, environmental disasters, climate changes (also caused

by pollution). Exposure starts already in the womb and it can show immediate effects or build over time to increase disease risk later in life (WHO, 2017, p. xiii). One does not have to be a scientist to see, understand and recognise what is so obviously going on – environmental degradation and pollution, caused by human action, seriously exacerbates children's living conditions. History and progression of environmental human rights reflect the crucial role of the United Nations (UN) in their emergence in the global legal order as well as their spreading through education and assistance provided to states members by different UN agencies, for example, World Health Organisation (WHO) and United Nations Children's Fund (UNICEF) (Collins, 2015, p. 220, 223). The same applies to children's rights. Adoption and coming into force of the UN Convention on the Rights of the Child (the CRC; the Convention) (Službeni list SFRJ 15/1990, Narodne novine-Međunarodni ugovori 12/1993, 20/1997) are arguably seminal moments in human rights law development in general and, of course, especially in the field of child's rights.

Even though it has been 45 years since it brought the concept of a right to environment in the Declaration of the United Nations Conference on the Human Environment (the Stockholm Declaration; http://www.un-documents.net/aconf48-14r1.pdf) and despite numerous instruments adopted and activities undertaken with the aim of improving the human's environmental conditions (for more details see, e.g.: Aust, 2005, p. 327-344; Bertollini, 2015, p. 517-527), the UN still hesitate to explicitly recognise the human right and the child's right to a clean and healthy environment. Even though the CRC is the most comprehensive human rights treaty, covering the child's civil, political, economic, social and cultural rights, the child's right to a clean environment is not one of the many rights that the Convention explicitly guarantees. Nevertheless, this paper rests on the view that the child's right to a clean environment exists at least as a right that can be derived from other child's rights explicitly recognised in the CRC, particularly the right to life, highest attainable standard of health, and an adequate standard of living; it is a right whose realisation is *sine qua non* of the former mentioned rights and thus virtually all the child's rights recognised by the CRC. This paper focuses on the obligations of the governments arising from the CRC. Focusing on the CRC is logical considering the fact it is the only global human rights treaty explicitly referring to environmental issues, that is, the dangers of environmental degradation in relation to the child's health (Koivurova, Duyck, Heinämäki, 2013, p. 297). Besides that, the Convention is binding in almost all countries of the world – it is well-known for being the most universally ratified human rights treaty in the UN's history, with 196 States Parties, and with only the USA not ratifying it. Unequivocal evidence of the negative impact of environmental hazards on children justifies reflecting and reminding the governments about their obligations to protect children's lives.

2. THE CRC AS A GROUND FOR THE CHILD'S RIGHT TO A CLEAN ENVIRONMENT

2.1. Life, health, development, adequate standard of living and the environment

It was clear from the start that the CRC is taking a holistic and comprehensive approach to children's rights because strong interconnectedness and interdependence simply do not allow the hierarchy between the rights guaranteed. Still, it is worth mentioning that four of the CRC's provisions were highlighted as its general principles: non-discrimination (art. 2), best interest of the child (art. 3), the right to life, survival and development (art. 6) and the right to express views and participate (art. 12).It is rather obvious that many of the legal obligations and moral aspirations covered by the CRC depend on the provision of a clean and healthy environment (Jansen, 2000, p. 209). Child's right to a clean and healthy environment both underlines and derives from, particularly, the child's right to life, survival and development (art. 6), the right to the highest attainable standard of health (art. 24) and the right to an

adequate standard of living, including nutrition, water, clothing, housing (art. 27) and it is also implicitly connected to several other CRC provisions, for example, the best interests of the child (art. 3), the right to be heard (art.12) , aims of education (art. 29), rights to play or recreational activities (art. 31).

The right to life, in its substantive and normative formulation, is a precondition of all the other child's rights (Hrabar, 1994, p. 90) and as such it is the most fundamental of all human rights of the child. Children under five years of age are one of the groups most affected by environmental risk factors; estimated 26% of the 5.9 million deaths per year in that age group are attributable to the environment (WHO, 2017, p. 14) and this does not account for children who die after that age, or those who suffer from non-fatal diseases or disabilities (Committee on the Rights of the Child, 2016, p. 10). Sadly, the great majority of child deaths and suffering result from preventable causes, above all poverty, preventable diseases, malnutrition, lack of access to clean water, poor hygienic conditions and insufficient health and education services. Harsh (and it should be), but true - these deaths are human-made and the main responsibility lies on governments (Nowak, 2005, p. 1). The child's right to life is not exhausted on ensuring the mere survival and extends to cover the obligation of ensuring the development of the child to the maximum extent possible. The right to survival and development of the child is a holistic concept that can only be implemented through the enforcement of all the other CRC provisions (Committee on the Rights of the Child, 2006, para. 10). The concept of development is not just about the preparation of the child for adulthood. Instead, it is about providing optimal conditions for childhood, for the child's life now (Hodgkin, Newell, 2007, p. 93). The concept of child development is further expanded in the health domain by the article 24 of the CRC which not only guarantees the right of every child to the highest attainable standard of health but also addresses most factors contributing to that right, thus increasing the possibility of this right being realised (Reinbold, 2014, p. 506-507). In order to fulfil their obligations in this regard, the States Parties should take appropriate measures, particularly reduce infant and child mortality, combat disease and malnutrition, provide adequate nutritious foods and clean drinking water, taking into consideration the dangers and risks of environmental pollution. Furthermore, the States Parties should provide appropriate prenatal and postnatal health care for mothers and ensure that all segments of society, in particular parents and children, have access to education on the child health, hygiene and environmental sanitation. Environmental hazards are thus recognised explicitly as inextricably linked to the child's state of health and, by default, its life. In pursuit for the full implementation of this right the States Parties also undertake to promote and encourage international cooperation, acknowledging that particular account should be taken of the needs of developing countries. Poor environmental quality contributes to significant portion of the global burden of disease. For example, there is a growing pandemic of disabilities associated with exposure to environmental hazards during childhood (Committee on the Rights of the Child, 2016, p. 4); air pollution is a suspected neurotoxin, a major asthma trigger and over time it can lead to chronic deficits in lung function (WHO, 2017, p. 49); even relatively low levels of lead exposure can cause serious neurological damage and lowering the child's IQ, among other effects (UNEP and WHO, 2010, p. 42); exposure to environmental hazards can permanently affect child's immune system (for details see: Boule, Paige Lawrence, 2016). As stated above, article 24 specifically recognises several factors as essential for ensuring the highest attainable standard of health. Of special importance is the explicit recognition of risks and dangers of environmental pollution which need to be taken into account as factors obstructing the realisation of this right (art. 24(2)(c) CRC). One of the obstacles in ensuring the child's right to the highest attainable standard of health is the fact that a lot of environmental policies and legislation is based on the findings on adults' reactions to environmental pollution (Bistrup, 2000, p. 203.) even though it is the

child who suffers more life and health threatening damage when exposed to contaminated environment. Children are much more susceptible to environmental causes, especially during periods in early development – called "windows of vulnerability"- when their vital organs are forming and rapidly developing and when even minimal exposure to toxic chemicals can lead to permanent damage to their brain, immune system etc. These windows have no counterpart in adult life. This heightened susceptibility to environmental influences is the result of several factors: children have proportionately greater exposures to toxic chemicals on a body-weight basis because of their disproportionately large intakes of air, food, water; children's metabolic pathways are immature and their ability to metabolise toxic chemicals is different from that of adults; their extremely rapid and exquisitely delicate development is easily disrupted; children have more time than adults to develop chronic diseases that may be triggered by environmental exposures in early life stages (for details see: Etzel, Landrigan, 2015). In order to tackle and minimise the risks of environmental pollution in all settings, States should provide the core requirements of a healthy upbringing and development including adequate housing, a smoke-free environment, effective management of waste and the disposal of litter from the immediate surroundings and the absence of toxic substances (Committee on the Rights of the Child, 2013b, para. 49). Hazardous environment toxins, such as lead, mercury, asbestos, all commonly found in most countries, influence, for example, the child's immune system (Boule, Paige Lawrence, 2016, p. 21-54) and also contribute to the causes of many disabilities which requires policies to prevent dumping of hazardous materials and other means of polluting the environment (Committee on the Rights of the Child, 2006, para. 53-54). The Committee points to the relevance of the environment, beyond environmental pollution, to children's health. Environmental interventions should put children's health concerns at the centre of their strategies on climate change which is one of the biggest threats to children's health (Bakker, p. 82), acting like a threat multiplier, compounding problems with food, nutrition and water insecurity (Committee on the Rights of the Child, 2016, p. 12). This clearly confirms the need for extensive interpretation of environment and thus comprehensive approach to environmental impact on children's lives. Furthermore, article 24 reflects awareness of the fact that the exposure to dangerous environmental influences during prenatal and infancy period can result in serious and permanent damage and that the mother's exposure to damaging environmental conditions also negatively affects the child's development. The child's postnatal growth is determined by both genetic and environmental factors and is strongly influenced by prenatal growth (for details see: Sly, 2012; Etzel, Landrigan, 2015). Thus, the article 24 follows the line of thought started in the Preamble of the CRC which states the need for special safeguards for the child before and after birth. The States Parties should seriously take into account the Committee's strong message about preventable maternal mortality and morbidity as grave violations of the human rights of women, and their own and their children's right to health (Committee on the Rights of the Child, 2013b, para. 51). The right to water is one instantiation of the substantive right to a safe and healthy environment (Collins, 2015, p. 232). Lack of access to clean water and its pollution are some of the most serious environmental issues in general with predictable devastating repercussions for future generations. Population growth, urbanisation, industrialisation, are all increasingly pressuring water resources, their quality as well as quantity (Jansen, 2000, p. 215). Global efforts and investment in drinking-water supply infrastructure resulted in 2.6 billion people gaining access to an improved source of water between 1990 and 2015. However, recent surveys including direct measures of water quality suggest that at least 1.8 billion people globally drink water that is contaminated with faeces. Children under five years of age are the most vulnerable to the effects of unsafe water; intestinal diseases, including diarrhoea, parasitic infections and environmental enteropathy impair the functioning of the gut and prevent the absorption of nutrients essential for a child's

growth and development. Children who are malnourished or dehydrated are especially vulnerable (WHO, 2017, p. 24-25). Malnutrition is also closely linked to the state of the environment. Only the clean environment can support adequate and sustained food production and contribute to breaking the interaction between malnutrition and infection. Disease spreads more easily in an unclean environment while malnutrition increases chances of infection. Children are most vulnerable to the compromised food security occurring as a result of natural resource degradation and pollution (Jansen, 2000, p. 214-215, 218-219). Food can contain biological contaminants and a wide range of chemical contaminants such as methylmercury and other heavy metals, and children are most at risk. Even for chemicals to which humans are not particularly sensitive, the lower body weight of babies and young children can lead to exposures above the safe levels (WHO, 2017, p. 72). It follows that it can be argued the child's health depends at least as much on the environmental causes and their control, as on the health services' response to disease. This requires measures to improve the environment to be considered the most fundamental for attaining the highest standard of child's health (Jansen, 2000, 213). It follows further that the realisation of the highest attainable standard of health requires measures beyond social welfare and health care services. Full implementation requires the States Parties to undertake the necessary measures to the maximum extent of their resources including within the framework of international cooperation. This implies an immediate obligation to start adopting measures that are within the means of the State, and to progressively advance the realisation of the right when additional resources become available (Eide, Barth Eide, 2006, p. 15). Health is a global, national, and individual concern (ibid., p. 3) so, in environmental context, it is necessary to recognise the indivisibility of environment protection and development process and to take constructive approach to the right to health from an environmental perspective (Ksentini, 1994, para. 184). To us it seems there is no alternative because article 24, as well as the article 6 of the CRC, cannot be fully implemented without protection from environmental harms. Besides the article 24, environmental contamination and exposure is addressed also in CRC article 27 (Reinbold, 2014, p. 508) which recognises the child's right to a standard of living adequate for its physical, mental, spiritual, moral and social development, including adequate nutrition, clothing and housing. Fulfilling the requirements of article 27 in connection to environment issues includes, for example, housing which is not built on polluted sites or in immediate proximity to pollution sources; providing the pregnant women with adequate nutrition, since under or malnutrition during pregnancy can seriously affect the future life of the child (Eide, 2006, p. 16, 22); it should include, for example, establishing adequate regulatory mechanisms for preventing the production and distribution of clothing and toys treated with dangerous chemicals. However, the right to an adequate standard of living goes beyond the purely material aspects and requires that the child's living conditions enable its development into a fully capable and well-functioning adult person (Eide, 2006, p. 5, 17) in accordance with the holistic approach to concepts of survival and development (Committee on the Rights of the Child, 2006, para. 10). Article 27 requires broader economic programmes and policies (Reinbold, 2014, p. 513). Placed in environmental context, it is clear that the right to life, the highest attainable standard of health, and the right to an adequate standard of living can be interpreted only as including the provision of an environment supportive of child's health (Jansen, 2000, p. 213), and only a clean environment can be considered to be healthy and provide the child with a surrounding supportive of its overall well-being.

2.2. Other CRC provisions in environmental context

Unique to the CRC and reflecting the growing urgency of concern about the environment (Hodgkin, Newell, 2007, p. 450) is the provision of article 29(1) that covers the aims for the

education of the child and requires that its education be directed, *inter alia*, to the development of respect for the natural environment. Generally speaking, education must be designed to reinforce all the ethical values enshrined in the CRC and the aims of education set out in article 29(1) support and protect the core values of the Convention: the human dignity of the child and its inalienable rights (Committee on the Rights of the Child, 2001, para. 1). In the context of developing respect for the natural environment, education should link issues of environment and sustainable development with socio-economic, socio-cultural and demographic issues. Respect for the natural environment should be learnt by children at home, in school and within the community, encompass both national and international problems, and actively involve children (para. 13), which suggests that the environmental education cannot remain on purely theoretical basis. Emphasising the importance of environmental education and developing a child's sense of respect for the natural environment suggests implicit acceptance of the concept of inter-generational equity (more on the concept in, e.g.: Fitzmaurice, 1999), the duty of present generations to ensure that in using natural resources they do not compromise the ability of future generations to meet their needs. Looking at the article 29(1) from another point of view, we can see that corresponding to the child's right to grow in a clean environment are the duties and responsibilities which children have to assume as they mature in order to preserve the environment for themselves and future generations (Jansen, 2000, p. 221). Education can be child's main source of environmental information and a tool for empowering children to become actors of change in environmental context (Committee on the Rights of the Child, 2016, p. 18). The best interest of the child is also one of the general principles of the Convention. Article 3 requires taking the best interests of the child as a primary consideration in all actions concerning children and obliges the States to ensure necessary protection and care for the child, taking account of rights and duties of parents and others legally responsible for it. This duty applies to all decisions and actions that directly or indirectly affect a child, children as a group or children in general, even if they are not the direct targets of the measure (Committee on the Rights of the Child, 2013a, para. 19). The implementation of the best interest of the child standard requires States to ensure necessary protection and care for all children in their jurisdiction. Parents bear the primary responsibility for their children but there are many aspects of care and protection that individual parents cannot provide. Protection against environmental pollution and environmental disasters are such situations where the State has the active obligation to provide and protect the child's well-being (Hodgkin, Newell, 2007, p. 40-41). In any case, the determination of the child's best interest requires hearing the child's views (Korać Graovac, 2012, p. 125). Instead of an object fettered between obedience and acceptance, thanks to the CRC the child became an active participant in matters and relations that concern him, including determining its best interest (Jakovac-Lozić, 2005, p. 136.). The child's right to participation, as recognised in CRC article 12, is one of the four general principles of the Convention, as already stated above, and as such it is relevant to all aspects of implementation of the CRC and to the interpretation of all other articles. Article 12 recognises the right of the child to express its views freely and have its views given due weight in all matters affecting the child and in any judicial and administrative proceedings affecting it. This covers essentially every formal decision-making affecting the child in, for example, health, environment or the living conditions (Hodgkin, Newell, 2007, p. 149). Article 12 also has the potential to enhance substantially the fulfilment of the aims of education (Parkes, 2013, p. 124).

While there is no doubt about the importance of children's participation in environmental matters, concerns are being raised in this regard in the sense that it is not right to expect children to address the damage done by adults. It is justifiably argued that instead of increasing children's participation, adults should start acting for the benefit of the planet they

are leaving for their children. Besides that, it is often impossible to hear children's opinion (Committee on the Rights of the Child, 2016, p. 19-20) not to mention the prenatal and infancy period when the child is incapable of forming its own views. The Committee also expresses concern about the threats of the polluted environment to the child's right to play, especially in urban environments, where the design and density of housing, commercial centres and transport systems combine with noise, pollution and all manner of dangers thus creating a hazardous environment for children (Committee on the Rights of the Child, 2006, para. 34). The child's right to freedom of conscience (CRC art. 14) also covers environmental issues (Hodgkin, Newell, 2007, p. 186). One of the requirements of a healthy development is the regulation and monitoring the environmental impact of business activities (Committee on the Rights of the Child, 2013b, para. 49). Taking into account that the business sector's (national and transnational) impact on children's rights has been growing in the past decades, the Committee clarifies the States' obligations in that area (Committee on the Rights of the Child, 2013c, para. 2-3). While the business enterprises can contribute to advancing the realisation of children's rights through, for example, technological advances and different investments, it can also negatively impact children's rights (para. 1) in different ways: environmental degradation and contamination arising from such activities can compromise children's rights to health, food security and access to safe drinking water and sanitation; selling or leasing land to investors can deprive local populations of access to natural resources linked to their subsistence and cultural heritage; the rights of indigenous children may be particularly jeopardised in this context (para. 19). All of that requires effective regulation and monitoring of environmental impact of business, including establishing clear and well-enforced law and standards on health and environment that comply with the Convention (para. 20 and 29). And yet, countless environmental chemicals, to give just one example, have been presumed safe and do not require assessment of their impacts on children which essentially means permitting the children's exposure to dangerous substances (Committee on the Rights of the Child, 2016, p. 10).

2.2. The States Parties' obligations and their limitations

The CRC provisions clarifying the States Parties' obligations regarding the enforcement of the child's rights are also of relevance to the child's right to a clean and healthy environment. The CRC rests on the view of the family being the natural environment for the child's development and the States are to respect the parents' primary responsibility for their child (art. 18 CRC). However, parents are not the only ones responsible for creating a healthy environment for their children. More precisely, it is primarily the States' responsibility to take all necessary actions for realisation of the said child's right (Doek, 2010, p. 146). Article 4 CRC generally requires the States Parties to undertake all appropriate measures for the implementation of the rights recognised in the Convention, be it legislative, administrative or other kind of measures, included within the framework of international cooperation. The Committee has further elaborated in detail on the general measures of implementation thus creating an infrastructure for implementing the CRC (ibid., p. 145) stressing, for example, that the strategies aiming at ensuring child's rights must not be simply a list of good intentions; they must include a description of a sustainable process for realising the rights of children, real and achievable targets, specific goals, targeted implementation measures and allocation of financial and human resources (Committee on the Rights of the Child, 2003, para. 32). Furthermore, articles 18 and 27 of the CRC provide for States Parties' responsibilities in both general and specific terms. States Parties are required to provide assistance to all the parents in the performance of their responsibilities towards their children, not only for e.g. parents in need of assistance because of certain difficulties, and with a specific goal of implementing the rights enshrined in the CRC. As described above, article 27

requires States Parties to take appropriate measures to assist parents to implement this right, including material assistance and support programmes particularly with regard to nutrition, clothing, and housing. For child's rights to be meaningful, States are obliged to provide effective remedies and reparations for violations of those rights since children's special and dependent status creates real difficulties for them in that area (Committee on the Rights of the Child, 2003, para. 24). With regard to determining the level or form of reparation, it is significant that the Committee calls for taking into account that children can be more vulnerable to the effects of abuse of their rights than adults and that those effects can be irreversible and result in lifelong damage. Because of the evolving nature of children's development and capacities, reparation should be timely in order to limit ongoing and future damage to the child so when children are identified as victims of environmental pollution, immediate steps should be taken by all relevant parties to prevent further damage to the health and development of children and repair any damage done (Committee on the Rights of the Child, 2013, para. 31). The implementation of the Convention could not have been left to the goodwill of the States Parties so in order to avoid that the Convention would not eventually become just a 'dead letter', the CRC established a special body vested with a task to monitor its implementation - the Committee on the Rights of the Child. Member States are obliged by article 44 of the CRC to submit to the Committee their reports on the measures undertaken in order to implement the Convention, the progress made and the possible difficulties they encounter in that regard (Cvejić Jančić, 2016, p. 4). On the other hand, the realisation of the CRC rights is obstructed with certain limitations to the States' obligations. The most general limitation is found in article 4 that obliges States Parties to undertake measures with regard to economic, social and cultural rights of the child but only "to the maximum extent of their available resources". It follows that the States Parties are not required to immediately realise those rights in full and that the concept of "progressive realisation" is applied as it is necessary to realistically accept the lack of available resources in some States (Reinbold, 2014, p. 515-516). Similar limitation is found in article 24 which recognises the child's right to only "the highest attainable" standard of health. Even though this might be a necessary limitation as the guarantee of right to be healthy would be unrealistic, this phrase is a potential cause of concern because it is easy to overuse it in escaping States Parties' responsibilities. Same applies to article 27 requiring a standard of living that is only "adequate" for the child's development whose limitation is even more problematic because of potential conflict with the States' obligation under article 4 to implement rights to the maximum extent of their available resources (ibid., p. 518-519). The best interest of the child is probably the most 'famous' CRC provision as it must be respected in absolutely all actions concerning children regardless of who is taking that action. However, article 3 itself limits the scope of that universal standard by stating that the best interest of the child is not the determining consideration, but only "a" primary consideration. Even though only in limited circumstances should the child's best interest not prevail, this formulation permits overriding that interest (Freeman, 2007, p. 5). Monitoring mechanism over the implementation of the Convention also limits its enforcement. The only explicit mean of monitoring available to the Committee are the States Parties' periodic reports. The Committee can only make suggestions and recommendations to States Parties which makes its authority pretty weak (Reinbold, 2014, p. 521-522). With the coming into force of the Optional Protocol to the Convention on the Rights of the Child on a communications procedure in 2014 the Committee gained power to decide on individual complaints but it will probably take a long time before any results are visible considering the very small number of ratifications (only 33 at this moment).

3. CONLUDING REMARKS

The environmental conditions are the basis for the rights of the child, starting from the conception as that developing entity, just like any other natural organism, needs an appropriate habitat in order to survive and develop (Westra, 2014, p. 8). The data presented in this paper is just a drop in the sea of scientific evidence of destructive consequences of environmental degradation but is enough to demonstrate that the destruction of environment is happening now, causing irreversible damage to children's lives, violating their rights. By ratifying the Convention, governments took upon themselves to enforce the right it guarantees to the maximum extent of their available resources which requires the progressive reduction and ultimately elimination of environmental risks in order to protect the right to life, and thus all the other child's rights. Limitations of this paper do not allow for detailed examination of significant number of international instruments on environmental protection. Environmental conventions are arguably rather effective instruments in addressing global environmental issues (Bertollini, 2015, p. 525) and the UN has been a leader in that area from the 1970's. What seems more important at this point is the fact that one crucial global instrument is lacking – the one that would explicitly recognise the human right and the child's right to a clean environment. Environmental hazards are widespread and transcend national boundaries, for example climate change or hazardous chemicals, so global nature of these dangers requires global regulatory mechanisms and action on all levels. Such an instrument would facilitate, empower and give impetus to the efforts in environmental protection. Visible progress has already been made as a result of investing in environmental interventions for improving child's living conditions but the hardest part is yet to come. That is why clear legal ground for child environmental rights should be established, especially with a view of new emerging environmental risks such as growing volume of electronic waste. Aiming to foster a deeper understanding of the contents and implications of the CRC with regard to environmental issues, the Committee dedicated its 2016 Day of General Discussion to the topic of children's rights and the environment. Confirming that the impact of environmental damage on children's health is a well-known thing the Committee also states that the understanding of relationship between children's rights and the environment is still in its infancy, despite the proven explicit link between the environmental harm and child rights violations, increased awareness of environmental crisis and numerous international agreements (Committee on the Rights of the Child, 2016, p. 1). However, apart from reminding and the clarification of some details regarding States Parties' obligations and bringing out the latest numbers, e.g. on children's lives lost due to environmental hazards, the Committee failed to take a step forward and plead for drafting a new instrument that would explicitly recognise the child's right to a clean environment. Instead, it only promised to consider "further adequate steps" (ibid. p. 38). Considering the state of the environment today and the Earth's natural resources perspective for the future, the interdependence of the child's fundamental rights and the clean environment, and especially the children's particular susceptibility to environmental exposure, recognition of the child's right to a clean environment could be considered a matter of common sense. Not taking efficient measures to protect children against preventable causes of death and disease is gravely violating their rights. Unfortunately, those who really have the power to make decisions do not care about that. In this regard, we fully concur with the view that global corporations have almost unlimited 'rights' today vis-á-vis human individuals who are regularly victimised through the environment by their products and activities. Their accruing profit is only increasing their already excessive power at the expense of the rest of the humanity, especially children (Westra, 2014, p. 25). In today's morally impoverished world lives, health and the overall future of humanity are being traded for profit and there is no point in appealing to the conscience of majority of people. Hopefully, those who care for profit only could finally

listen to the World Bank's message about investing in young children as an opportunity for high returns (World Bank, 1993; Denboba, Elder, Lombardi, Rawlings, Sayre, Wodon, 2014). The costs of the environmental damage to children's lives are enormous. To give just one example, the neurodevelopmental effects of childhood lead exposure and lost productivity from exposure cost almost US$ 1 trillion every year in low- and middle-income countries (WHO, 2017, p. 16). So perhaps the pure economical calculations could be an incentive to invest in environmental protection.

LITERATURE:

1. Anton, D.K., Shelton, D.L. (2011). *Environmental Protection and Human Rights*. New Work: Cambridge University Press.
2. Aust, A. (2005). *Handbook of International Law*. New York: Cambridge University Press.
3. Bakker, C. (2016). Climate change and right to life: Limits and potentialities of the human rights protection system. In O. Quirico, M. Boumghar (eds.), *Climate Change and Human Rights. An international and comparative law perspective* (p. 71-88). London; New York: Routledge.
4. Bertollini, R. (2015). Global Treaties and Children's Environmental Health. In P.J. Landrigan, R.A. Etzel (eds.), *Textbook of Children's Environmental Health* (p. 517-527). New York: Oxford University Press.
5. Bistrup, M.L. (2000). The susceptible child - does the child have a right to a healthy and a safe environment? In A. Fijalkowski, M. Fitzmaurice (eds.), *The Right of the Child to a Clean Environment* (p. 199-207). Aldershot, England; Burlington, USA: Ashgate Dartmouth.
6. Boule, L.A., Paige Lawrence, B. (2016). Influence of Early-Life Environmental Exposures on Immune Function Across the Life Span. In C. Esser (ed.), *Environmental Influences on the Immune System* (p. 21-54). Wien: Springer.
7. Boyle, A. (2012). Human Rights and the Environment: Where Next? *The European Journal of International Law*, vol. 23, no. 3 (p. 613-642).
8. Brei, A. T. (2013). Rights & Nature. Approaching Environmental Issues by Way of Human Rights. *Journal of Agricultural and Environmental Ethics*, vol. 26, no. 2 (p. 393-408). Retrieved 1.5.2017. from http://link.springer.com/article/10.1007/s10806-012-9385-z.
9. Collins, C. (2015). The United Nations, human rights and the environment. In A. Grear, L. Kotzé (eds.), *Research Handbook on Human Rights and the Environment* (p. 219-244). Cheltenham, UK, Northampton, MA, USA: Edward Elgar Publishing.
10. Committee on the Rights of the Child (2016). *Report of the 2016 Day of General Discussion: Children's Rights and the Environment*. Retrieved 19.4.2017. from http://www.ohchr.org/EN/HRBodies/CRC/Pages/Discussion2016.aspx.
Committee on the Rights of the Child - General Comments - Retrieved 17.4.2017.
from http://www.ohchr.org/EN/HRBodies/CRC/Pages/CRCIndex.aspx:
11. Committee on the Rights of the Child (2001). *General Comment No. 1 (2001). Article 29 (1): The aims of education*, CRC/GC/2001/1, 17 April 2001.
12. Committee on the Rights of the Child (2003). *General Comment No. 5 (2003): General measures of implementation of the Convention on the Rights of the Child (arts. 4, 42 and 44, para. 6)*, CRC/C/GC/2003/5, 27 November 2003.
13. Committee on the Rights of the Child (2006). *General Comment No. 7 (2005): Implementing child rights in early childhood*, CRC/C/GC/7/Rev.1, 20 September 2006.
14. Committee on the Rights of the Child (2007). *General Comment No. 9 (2006): The rights of children with disabilities*, CRC/C/GC/9, 27 February 2007.
15. Committee on the Rights of the Child (2013a). *General comment No. 14 (2013) on the right of the child to have his or her best interests taken as a primary consideration (art. 3, para. 1)*, CRC/C/GC/14, 29 May 2013.

16. Committee on the Rights of the Child (2013b). *General comment No. 15 (2013) on the right of the child to the enjoyment of the highest attainable standard of health (art. 24)*, CRC/C/GC/15, 17 April 2013.
17. Committee on the Rights of the Child (2013c). *General comment No. 16 (2013) on State obligations regarding the impact of the business sector on children's rights*, CRC/C/GC/16, 17 April 2013.
18. Cvejić Jančić, O. (2016). Rights of the Child in a Changing World. In O. Cvejić Jančić (ed.), *The Rights of the Child in a Changing World: 25 Years after The UN Convention on the Rights of the Child* (p. 1-36). Springer International Publishing Switzerland.
19. Declaration of the United Nations Conference on the Human Environment (1972). In *Report of the United Nations Conference on the Human Environment*, Stockholm, 5-16 June 1972, A/CONF.48/14. Retrieved 17.3.2017. at http://www.un-documents.net/aconf48-14r1.pdf.
20. Denboba, A.D., Elder, L. K., Lombardi, J., Rawlings, L.B., Sayre, R.K., Wodon, Q.T. (2014). *Stepping up early childhood development: investing in young children for high returns*. Washington, D.C.: World Bank Group. Retrieved 7.4.2017. from http://documents.worldbank.org/curated/en/868571468321240018/Stepping-up-early-childhood-development-investing-in-young-children-for-high-returns.
21. Doek, J.E. (2010). The UN Convention on the Rights of the Child: An Instrument for Creating a Healthy Environment for the Child. In J. Garbarino, G. Sigman (eds.), *A Child's Right to a Healthy Environment* (p. 139-148). New York: Springer.
22. Eide, A. (2006). *Article 27: The Right to an Adequate Standard of Living*. Leiden: Martinus Nijhoff Publishers.
23. Eide, A., Barth Eide, W. (2006). *Article 24: The Right to Health*. Leiden: Martinus Nijhoff Publishers.
24. Etzel, R.A., Landrigan, P.J. (2015). Children's Exquisite Vulnerability to Environmental Exposures. In P.J. Landrigan, R.A. Etzel (eds.), *Textbook of Children's Environmental Health* (p. 18-27). New York: Oxford University Press.
25. Fitzmaurice, M. (1999). The right of the child to a clean environment. *Southern Illinois University Law Journal*, vol. 23, no. 3 (p. 611-656).
26. Francioni, F. (2010). International Human Rights in an Environmental Horizon. *The European Journal of International Law*, vol. 21, no. 1 (p. 41-55).
27. Freeman, M. (2007). *Article 3: The Best Interests of the Child*. Leiden: Martinus Nijhoff Publishers.
28. Hajjar Leib, L. (2010). *Human Rights and the Environment: Philosophical, Theoretical and Legal Perspectives.* Leiden; Boston: Martinus Nijhoff Publishers.
29. Healthy Environments for Healthy Children – Key Messages for Action (2010). France: United Nations Environment Programme and World Health Organization. Retrieved 29.4.2017. from http://www.who.int/ceh/publications/hehc_booklet_en.pdf?ua=1.
30. Hodgkin, R., Newell, P. (2007). *Implementation Handbook for the Convention on the Rights of the Child*. Geneva: United Nations Children's Fund. Also available online at https://www.unicef.org/publications/files/Implementation_Handbook_for_the_Convention_on_the_Rights_of_the_Child.pdf.
31. Hrabar, D. (1994). Dijete - pravni subjekt u obitelji. Zagreb: Pravni fakultet u Zagrebu.
32. Jakovac-Lozić, D. (2005). Prava djeteta kao pacijenta. Zbornik radova Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse. Mostar, no. 3 (p. 135-184).
33. Jansen, M. (2000). Children and the right to grow up in an environment supporting their health and well-being: A sound environment, provided for and encapsulated in the Convention on the Rights of the Child. In A. Fijalkowski, M. Fitzmaurice (eds.), *The Right of*

the Child to a Clean Environment (p. 209-228). Aldershot, England; Burlington, USA: Ashgate Dartmouth.
34. Koivurova, T., Duyck, S., Heinämäki, L. (2013). Climate Change and Human Rights. In E.J. Hollo, K. Kulovesi, M. Mehling (eds.), *Climate Change and the Law* (p. 287-325). Dordrecht: Springer.
35. *Konvencija o pravima djeteta*, Službeni list SFRJ 15/1990, Narodne novine - Međunarodni ugovori 12/1993, 20/1997.
36. Korać Graovac, A. (2012). Pravo djeteta da bude saslušano - Opći komentar br. 12 Odbora za prava djeteta (2009). In *Dijete u pravosudnom postupku: Primjena Europske konvencije o ostvarivanju dječjih prava* (p. 117-137). Zagreb: Pravobranitelj za djecu.
37. Ksentini, F. Z., Special Rapporteur on human rights and the environment (1994). *Review of Further Developments in the Fields with which the Sub-Commission has been Concerned*, E/CN.4/Sub.21/1994/9, 6 July 1994. Retrieved 29.4.2017. from http://hrlibrary.umn.edu/demo/HRandEnvironment_Ksentini.pdf.
38. Lewis, B. (2012). Environmental rights or a right to the environment: Exploring the nexus between human rights and environmental protection. *Macquarie Journal of International and Comparative Environmental Law*, vol. 8, no. 1 (p. 36-47). Retrieved 29.3.2017. from http://eprints.qut.edu.au/53993/1/03_Lewis.pdf.
39. Nowak, M. (2005). *Article 6: The Right to Life, Survival and Development.* Leiden: Martinus Nijhoff Publishers.
40. Parkes, A. (2013). *Children and International Human Rights Law: The Right of the Child to be Heard*. London: Routledge.
41. Reinbold, G. W. (2014). Realising Young Children's Right to Health Under the Convention on the Rights of the Child. *International Journal of Children's Rights*, vol. 22, no. 3 (p. 502-551).
42. Sly, P.D. (2012). Environmental Pollutants and Postnatal Growth. In V.R. Preedy, *Handbook of Growth and Growth Monitoring in Health and Disease* (p. 757-768). New York: Springer.
43. World Bank (1993). *World development report 1993: investing in health.* Oxford: Oxford University Press. Retrieved 11.3.2017. from https://openknowledge.worldbank.org/handle/10986/5976.
44. World Health Organization (2017). *Inheriting a sustainable world? Atlas on children's health and the environment*. Switzerland: World Health Organization. Retrieved 23.3.2017. from http://www.who.int/ceh/publications/inheriting-a-sustainable-world/en/.
45. Westra, L. (2014). Child Law: Children's Rights and Collective Obligations. Springer International Publishing Switzerland.

FLEXICURITY – WAY OUT OR WAY WITH TRAPS AND HURDLES?

Andrijana Bilic
Faculty of Law University of Split
andrijana.bilic@pravst.hr

ABSTRACT

In recent decades, the European labour market has been criticized for a lack of flexibility which is essential in the growing internationalisation of the economy and ever fluctuating labour demand. So, in this situation, state support for constraints on markets has weakened, resulting in a tendency towards liberalisation across the EU. Concerning employment regimes, the liberalizing tendency has been reflected in declining trade union membership, the decentralisation and erosion of collective bargaining, increasing inequality and „supply-side" reforms directed at weakening employment protection and linking benefit entitlements to participation in the labour market. Terms like »flexible firm« and "flexibility-security nexus" have emerged. In this paper, the author analyses strategies of flexibility that firms use in their attempt to become and stay competitive in the market, but also stress the importance of social security in the context of flexibility. These two opposing demands, namely flexibility and security, could be achieved through the concept of flexicurity. The author explains the reasons for growing interest in flexicurity, especially on the part of the European Commission. After analyzing the components of flexicurity, the importance of social dialogue in the process of its implementation is stressed and explained. Despite its innovative character, the flexicurity approach is criticized for several reasons which at the same time represent the main obstacles in its implementation. In the concluding remarks the author poses a few questions: does flexicurity represent just a mask to cover essentially deregulatory drive which gives priority to the needs of employers over the interests of employees? Furthermore, does flexicurity need to be re-thought and adapted to newly emerging situations in the labour market or replaced with deregulation?

Keywords: *flexible labour market, social security, critical flexicurity*

1. INTRODUCTION

In recent decades, the European labour market has been criticized for the lack of labour market flexibility which is essential in the growing internationalization of the economy and the more fluctuating labour demand as a consequence of socio-economic and political changes in society. At the same time, traditional programmes of social protection, largely modelled on the male-dominated, full-time and continuous career model, have become inadequate for the growing part of employees included in non-standard forms of employment, and who can hardly face the growing financial burden as a result of economic and demographic pressures. So, in this situation, state support for constraints on markets has weakened, resulting in a tendency towards liberalisation across the EU. The extent of social protection of the workers is being reduced while employment protection is under threat. In relation to employment regimes, the liberalising tendency has been reflected in declining trade union membership, the decentralisation and erosion of collective bargaining, increasing inequality and „supply-side" reforms directed at weakening employment protection and linking benefit entitlements to participation in the labour market. So, the erosion of social protection implies a reduced emphasis on the security dimension of flexicurity, „magic wand" for the resolution of labour market problems. Further tensions arise between incentives for increasing employment and greater flexibility and undesirable consequences of national programmes of prosperity, such as schemes of temporary retirement and unemployment, sickness and inability to work benefits and so on.

2. LABOUR MARKET FLEXIBILITY

The pressure on firms for adjustment to the changing market conditions resulted in emergence of "flexible firm". This refers to types of organizational forms that enable employers the achievement of required flexibility in order to maintain their competitiveness in the market. It is made up of three different labour force segments: the core group of workers possessing firm specific skills. These people work in high quality working conditions and have a high level of employment protection. The second group consists of peripheral workers, often employed on fixed-term and part-time employment contracts with a looser connection to the firm and the third group made up of external group of workers, not employed by the firm, but who later utilise their work through temporary agency work or they work as self-employed persons. In particular, in terms of labour (from the aspect of work, this ability to adapt is achieved through different strategies of flexibility which could generally be classified into numerical, functional (Bilić, 2017a) and financial flexibility (Atkinson, 1984), to which temporal flexibility could be added (Bilić, 2017b; Atkinson, 1985, 1985a, 1987**,** pp. 87-215; Smith, 1997, pp. 15-339; Hunter, McGregor, Macinnes, Sproull, 1993, p. 303- 407.)

Numerical flexibility enables employers to employ workers on the basis of atypical, non-standard work contracts (so called outsiders). Firstly used are fixed-term work contracts (Bilić, 2004; Bilić, Perkušić, 2016), those who work through agencies for temporary employment (Laleta, 2015) and those who work from a remote work place (distance work (Bilić, 2011). This concerns jobs characterized by low salaries and a precarious level of benefits and protection in the social security system. These atypical workers, most often women (Bilić, A., 2014) and the young are burdened with adapting to economic shocks. This results in an increased number of precarious jobs, a lack of professional training and development and, lastly, negatively influences productivity.

Functional flexibility enables workers to gain multilevel skills on the basis of which they can relatively easily reallocate to other tasks within employers' organizations (Cridland, 1997, p.21; Farnham, Horton, 1997, p.18-33). This practice has beneficial effects for workers, providing them competiveness in the market, and also for employers due to the possibility of using multi-qualified workers adapted to fast changes.

Given that intensifying competitiveness creates pressure on limiting salaries, attempts by employers are strong to link the amount of salary to the carrying out of work in order to allocate compensation for basic salary with various systems of replacement bonuses, so called system of variable salaries (Van Het Kaar, Grűnell, 2001). The same is achieved by **financial flexibility**. Three types or categories of systems of variable salaries can be differentiated: the system of salary according to results where there is a direct connection between worker salary and output; the system encouraging workers to work to certain standards without a connection to productivity such as salary based on performance; and the system of financial participation, where workers have the right to part of the company's profit. Institutions of the European Union have showed interest in variable salaries, especially related to promoting financial participation of workers in profits, results and capital of the company.

With **temporal flexibility** (Bilić, 2017b), which signifies that the number and schedule of hours of work are not fixed, employers more easily meet changing market demands. Namely, companies seek the most adaptable hours of work so that workers are accessible only when needed. The same is achieved by better organization of hours of work in a way that enables

deviating from the number of hours and their schedule during the day or week. Consequently, there are various models of hours of work grouping which is not only different between countries or economic sectors, but also among companies in the same industry or even among workers in the same company depending on the type of work they do. Three existing basic models of hours of work models emerge In industrialised countries these are: systems of hours of work which the state regulates and are primarily based on national legislation, and systems of hours of work based on collective agreements among social partners at a national, sector and company level and market oriented systems of hours of work, which, even if they can include laws and collective agreements, are primarily established on individual work contracts (Anxo, O'Reilly, 2002).

In regard to flexible organization of hours of work in industrially developed countries, three categories can be observed: overtime, alternative methods of allocating hours of work (Bilić, 2010, pp. 167-178) and part time hours of work **(**Laleta, Bilić, Barešić, 2016). Labour market flexibility is strongly connected to labour market regulations and institutions (Jackman, Layard, Nickell, 1996, p. 19-49; Siebert, 1997, p. 37-54.) Institutional flexibility covers following issues: labour market regulations; labour policy, trade union activities and labour taxes. Labour market regulations govern employment protection (unfair dismissal, restriction on lay-offs for economic reasons, compulsory severance payments, minimum notice period and so on) and labour standards (hours of work, fixed-term contracts, employment protection, and minimum wages). Institutional flexibility together with wage flexibility makes macro flexibility, besides which in the labour market we find micro-flexibility. Three types of labour market mobility are covered: worker flows (flows between unemployment, employment and inactivity), geographical mobility (internal, domestic or international mobility) and occupational mobility (mobility among different occupations). It is important to stress that all of these issues should be taken into account when creating proper measures of flexibility in the labour market.

3. SOCIAL SECURITY IN THE CONTEXT OF FLEXIBLE LABOUR MARKET

The right to social security is a basic human right. As such, it is guaranteed in fundamental international acts on human rights. In conjunction with the growing economic and active labour market policy, social security represents an instrument of sustainable social and economic development (International Labour Conference, 2001, p.17-23.). The transformation of productive methods, organizations of work and more flexible and less uniform careers demands the establishment of new standards of social protection. To this must be added the problem of mass unemployment which represents a particular strain on the system of social security. Under the influence of globalisation, European economies are faced with internal and external pressures regarding the sustainability of their national social models (Bodiroga-Vukobrat, 2002, pp. 51-61). The situation is made more complex by the fact that in the establishment of newly reformed systems of retirement and health insurance systems is the dilemma of whether to implement the European social model or the individual liberalist approach imposed by powerful financial institutions like the International Monetary Fund and World Bank (Bodiroga-Vukobrat, 2003, p. 73.). The European social model tries to incorporate the social protection of workers with industrial relations, inclusive labour market, better employment conditions, and effective regulation of economic competition, social inclusion and social cohesion. On the other hand, according to the individual liberalist approach, social institutions aimed at protecting workers such as minimum wages, collective wage bargaining, social protection systems and employment protection rules give employers little leeway to adapt to business cycle changes. Labour market demands, employers' aspirations to deregulate the labour market and union demands for an increasing level of job

security in particular for socially sensitive groups of the population are reflected in the document of the European Union (European Commission, 1993; 1997; 2006; 2006a). Similar to types of flexibility, we can distinguish four different forms of security: job security (the certainty of retaining a specific job with the same employer, e.g. via employment protection legislation); employment security (the certainty of remaining in a paid job, not necessarily in the same job with the same employer, e.g. via training and education; income security (the certainty of receiving adequate and stable levels of income in the event that paid work is interrupted or terminated; and combination security (the reliance on being able to combine work with private life – work-life balance (Wilthagen, Tros, 2017; Wilthagen, Tros, 2004, pp.166-186).

4. FLEXICURITY

In the context of the search for the „equilibrium" in flexibility-security nexus, the concept of „flexicurity" could represent a potential way out. The concept of flexicurity was first used by Dutch sociologist Hans Adriaansens in the mid-1990's in the context of the preparation of the Dutch Flexibility and Security act and Act concerning the Allocation of Workers via Intermediaries. As a result, the Dutch flexicurity model was born. Soon after, the Danish model of flexicurity was discovered as an alternative to the Dutch flexicurity model. This concept represents a policy strategy that attempts, synchronically and in a deliberate way, to enhance the flexibility of labour markets, the work organisation and labour relations, on the one hand, and to enhance security – employment security and social security – notably for weaker groups in and outside the labour market, on the other hand (Wilthagen, Rogowski, 2002, p.250; Wilthagen, Rogowski, 2004, p.169). A group of labour market researchers and a growing number of European countries became involved in research dealing with flexicurity. There are two reasons for this growing interest in flexicurity: successful Dutch and Danish models of flexicurity and the fact that flexicurity constitutes an alternative to a neo-liberal view of the labour market which argued for extensive deregulation and flexibilisation of the labour market, starting with the assumption that all forms of employee protection and social security interfere with the proper functioning of the labour market and, in the end, negatively affect economic growth and employment creation. The European Commission is the pivotal European actor in the promotion of the flexicurity. There are several reasons why has the Commission adopted the flexicurity concept and included it in the European Employment Strategy: its compatibility with the role of the Commission as disseminator of knowledge and „best practices" (Jacobsen, 2004; Wilthagen, Rogowski, 2002, p.250; Wilthagen, Rogowski, 2004, p.169) ; its role as a broker between economic interests and between national and political interests (Tsakatita, 2005, pp.193-220); and its discourse on the European Social Model (Jepsen, Serrano Pascual, 2005, pp. 231-245; Laleta, Bodiroga-Vukobrat, 2016, pp.33-69) as well as the relation between competitiveness and social cohesion. Realising that the European labour market has diverse problems apart from the core flexibility-security challenges, countries face other problems: two-tier labour markets, lack of job-to-job transitions in the case of redundancy, limited access to education and training for marginal groups and persisting long-term inactivity and informal work (European Commission, 2017). The European Commission, instead of providing detailed recommendations for each member state, has reached consensus about four policy components of flexicurity (European Commission, 2006):

- **Flexible and reliable employment protection arrangements;**
- **Effective active labour market policies;**
- **Comprehensive lifelong learning strategies:**
- **Modern social security systems**

In this way, the functioning of labour market is supposed to improve by: dealing with flexibility at the margin of the labour market by reducing asymmetries between standard and non-standard work and integrating non-standard contracts fully into labour law and collective agreements; promoting upward job-to-job transitions by reinforcing and promoting life-long learning and vocational training; strengthening dynamism and investments in skills; and increasing job opportunities of people by activating labour market and social security programmes (Bekker, Wilthagen,2008, p. 68-73). However, improvement of flexibility and security depends on the way in which institutions are designed and sufficient investments in social and human capital are made to warrant high levels of commitment and productivity. Nevertheless, it should be stressed that implementation of flexicurity is costly. At the same time, the rigid fiscal and monetary policy framework set by European Monetary Union is not favourable in the implementation of the flexicurity in its entireity. Proof of that is the fact that the United Kingdom, Sweden and Denmark are the only Member States who are not members of EMU and have fulfilled Lisbon employment goals in 2002. Also, national political and socio-cultural roots play an important role in this context.

4.1. Flexible and reliable contractual arrangements

Analysis suggests that although the impact of strict employment protection legislation (further: EPL) on total unemployment is limited, it can have a negative impact on those groups that are most likely to face problems of entry into the labour market, such as young people, women, older workers and the long-term unemployed (Algan, Cahuc, 2004; Nickel, Layard, 1999). Strict EPL often encourages recourse to a range of temporary contracts with low protection - often held by women and young people – with limited progress into open-ended jobs (European Commission, 2004). The result is segmentation of the labour market. Namely, the labour force is divided between insiders (full-time employees, with contract of unspecified duration who work on employers' premises and who enjoy a high level of employment protection) and outsiders (non-employed persons or workers with non standard employment contracts such as fixed-term, part-time, agency work, telework etc. whose work is characterised by a low level of employment protection), with opposite interests (Doeringer, Piore, 1971; Blanchard, Summers, 1986, p.15-78, Saint-Paul, 1996, pp. 264-315.) However, if the European Union's goal is to encourage lower employment protection and permit lower labour rights for non-standard workers, it will greatly damage Lisbon goals and the European Social Model. The integration of Common Principles of Flexicurity into the European employment policy, European Employment Strategy, the Lisabon strategy for Growth and Jobs and Europe 2020 Strategy are the clearest expression of the EU law flexicurity discourse (De Vos, 2009, pp. 209-235). Europe needs flexible firms and those need highly skilled, adaptable, motivated and loyal employees. So, one should bear in mind that EPL also has positive effects, in particular, it encourages enterprises to invest in training and promotes loyalty and higher productivity of employees. It is self understandable that, in down turn, firms need to fire and that in up-turn hire employees. However, in any case, for economic, as well as social reasons, core labour rights should be guaranteed to all workers regardless of their contractual status. Till now, this is done through Part-time, Fixed-term and Temporary Agency Work Directives and European Framework Agreement on Telework. Their general aim was to reduce labour market segmentation through principles of non-discrimination and equal treatment of non-standard workers and standard employees.

4.2. Active labour market policies

Active labour market policy is considered as necessary to achieve a balance between flexibility and employment security, reducing the risk of segmentation of the labour market and overall unemployment (European Commission, 2006; OECD, 2006**).** Active labour

market policy is created with the aim of promoting employment and undoubtedly is in favour of outsiders. On the other hand, the activity of this policy regarding tax and competiveness could threaten the interests of insiders in the labour market **(**Saint-Paul, 1998, pp.151-65; Calmfors, 1994).

Investments related to active labour market policy are closely related to reducing overall unemployment (OECD, 2006). In European Union and other European countries, various programmes of active labour market policy exist: professional development in the labour market, salary subvention in the private sector with the aim of promoting employment in the private sector, monetary aid subventions for persons in the self-employment category, direct job creation in the public sector and measures with the aim of increasing efficiency in searching for jobs (organized courses in searching for work, business clubs, professional orientation, providing advice and supervision and sanctions for not adhering to job seeker demands). Focus groups at whom active labour market policy is aimed are the youth, invalids and persons for whom finding work is difficult. A fundamental criticism aimed at active labour market policy is the issue of contributing in the case of unemployment, given that the same can potentially reduce the intensity of searching for work. However, it is possible to avoid eventual misuse to a great extent through effective active strategies coordinating contributing in case of unemployment by active labour market policy. Closely related to active labour market policy is the policy with the aim of establishing a balance between business and private life (European Commission, 2006, pp.15-20.)

4.3. Comprehensive lifelong learning strategies

This ensures worker adaptability and employability as well as maintaining the level of company productivity. The positives are greater employment and low long term unemployment. Investment in human resources during the span of working life, through the system of lifelong learning and strategies of so called active ageing, has been strongly promoted in European Union which is the result of rapid technological changes, innovations and demographic pressure. However, in this context, the aim of public policy could be contradictory to the aim of company training actions. Namely, public policies aim to prevent unemployment from becoming structural, aid job transitions, better match skills and jobs (World Economic Forum, 2014), better link skills upgrading to labour market requirements and increase labour market participation among young people, women, older workers and immigrants (Council of the European Union). On the other hand, employers tend to focus on specific training related to their production needs and working arrangements and all that for the most talented employees and those with the greatest need for learning, such as low skilled workers, workers on temporary contracts, self-employed, and older workers, who suffer most from underinvestment in training. Enterprises may be discouraged from investment in skills because trained staff may be recruited by other employers. In this conflicting situation, middle-skilled workers could be deprived of opportunities for career development. The above mentioned situation has been further complicated by radically reduced public and private budgets for funding lifelong learning. In recent years, the public policy approach in most European countries has shifted from direct subsidisation of external (public or private) providers of training services to co-financing schemes. Co-financing schemes in Europe are oriented both to firms (levy-grant schemes and train-or-pay scheme), individuals (loans, vouchers and individual learning accounts) and also there are arrangements that create incentives for employers and individuals to invest in skill development (pay-back clause, working time accounts for employees and apprenticeship contracts). So, it is easy to conclude that adult learning in the workplace and lifelong learning in general makes a great contribution to flexicurity and employment policies (European Commission, 2007).

4.4. Modern social security systems

Reform of the social security system, particularly the retirement and health insurance system must be implemented to achieve all-encompassing compatibility within the market economy framework and ensure that there is a certain type of support in the economic system and accelerate the transition process (Bodiroga-Vukobrat, 2008: 218).

Modern social security systems offering adequate unemployment benefits, as well as active labour market policies, are essential components providing income security and support during job changes. Good unemployment benefit systems are necessary to offset negative income consequences during job transfers, but they may have a negative effect on the intensity of job search activities and may reduce financial incentives to accept work. This can be largely offset by setting up efficient job search support and work incentives (OECD, 2005) to low-skilled benefit recipients, ensuring a balance between rights and obligations. Social security systems would ensure the possibility for temporary workers to accumulate rights and would improve portability of entitlements across firm or branch borders. They would also contribute to reducing non-wage labour costs of low-skilled workers. At the same time, work incentives and the conditionality of benefits, both, for workers and employers, need to be improved. They would encourage, on the one hand, people on benefits who can work to look for jobs and, on the other hand, employers to create new jobs. Components of social security that can serve to calculate flexicurity index are: unemployment insurance, paid holidays, paid maternity leave, public pension scheme and paid leave (Tangian, 2005.)

4.5. Social dialogue- *conditio sine qua non*

One of the prerequisites for the development of flexicurity and its effective implementation is supportive and productive social dialogue among social partners and public authorities, their mutual trust and a highly developed system of industrial relations. The most important part of flexicurity is the involvement of social partners defining the balance between security and flexibility, thereby legalizing and setting rules in the labour market. The most important flexicurity is including social partners, which defines the balance between security and flexibility, thereby legalizing and establishing labour market rules. Collective agreements and labour rulebooks can provide conditions for the modern work organization, improving numerical and functional flexibility, but all within the framework of worker security. Models of flexicurity are not developed by chance in those countries where social partners played an important role in finding the balance between flexibility and labour market security **(**Monks**,** 2007.) Namely, it is precisely those social partners who are in the position where they can best see the various needs of both workers and employers regarding flexibility and security and define their different modalities depending on the situation at a national or sector level, thereby legitimizing changes to and adaptation of rules which are imposed by a changing labour market or work organization.

It is evident that public powers play an important role in the implementation of flexicurity. They are the first who have to explain to citizens why some changes in society are necessary and to ensure measures and policies by which they will be implemented. Therefore, their role boils down to defining the legal framework and adopting policies which promote partnership in which all participants are ready to take on a part of the responsibility for change. Therefore, flexicurity is about shared responsibility **(**Kok, 2004:33).

5. CRITICS, DILEMMAS AND POSSIBLE WAY OUT

Despite its innovative character, the flexicurity approach is criticized for several reasons: its ambiguity and openness to political capture; its failure to problematize the creation and maintenance of institutional complementariness, its lack of attention to conflicts of interest and heterogeneity of the labour market and its reductionist view of the sources of flexibility

and security. Despite its ambiguous nature, diametrically opposed views on labour market problems and solutions (e.g. Rehn model and diversified quality production model (Streeck, 1991, pp.21-61) can fit in with flexicurity philosophy (Keune, Jepsen, 2007). Also, due to its ambiguous character, almost all actors stress the importance of flexicurity as the best instrument to tackle Europe's labour market problems, but all of them have different views on how to implement it. Flexicurity strategies can be conceived as searches for institutional complementariness which should produce positive-sum games between flexibility and security. Institutional complementariness means that the interplay between two institutions increases the functioning of both (Amable, 2003; Hancke, Rodhes, Thacher, (eds.), 2008.)
A good example is the so called „Danish golden triangle"(low dismissal protection, extensive unemployment benefits and active labour market policies). However, this approach fails to take into account the fact that complementariness emerges at different moments, independently from each other and not by design, but rather through the strategies of actors working within the institutions which depends on governance by the state and collective actors who are requisite for the functioning of the complementariness. At present, actors have not fostered complementariness, neither has the market which resulted in precarious workers emerging. It is important to stress that the creation and maintenance of complementariness could not neither be left to the market nor to the social partners. It requires active coordination between policy fields and continuous monitoring of their mutually relations. Another critic of the flexicurity approach perceives it as a win-win solution to further the interests of both workers and employers and leading to balance between flexibility and security. Namely, it is self evident that there are fundamental differences of interest between capital and labour and that the globalisation strengthens the power position of capital over labour. Also the fact that power relations and social conflict are a common feature of all capitalist political economies and historically constitute an important engine of change is neglected. A further problem of the flexicurity debate is that it is based on the reductionist view of the sources of the flexibility and security. By focusing on national-level institutions and policies, supposing that national labour markets are homogenous entities, it overlooks significant differences within same national economy, sectors or enterprises regarding exposure to international competition, degree of unionisation, skill levels, impact of immigration and so on. So national reforms in promotion of flexicurity need to take into account level in which those differences take place. Also, other sources of regulations like collective agreements, company policies and informal rules are neglected. So it is important to stress that in the explanation of the functioning of the concept of flexicurity the macro level is not sufficient. Namely, macro-level institutions set constraints, but do not prescribe behaviour of micro-level actors (firm-level). Furthermore, it leaves space for them to develop strategies according their interests. Also, national policies may provide incentives for companies to promote certain behaviour, but it is up to companies and worker representatives if they will respond to those incentives and in what way. Finally, some issues related to flexibility and security either do not exist in national legislation or it determines collective agreements as a source for setting standards. The use of this possibility depends on the bargaining partners, their interests and power distribution among them.

6. INSTEAD OF A CONCLUSION – NEXT STAGE OF FLEXICURITY

At present at European level there is widespread concern that the concept of flexicurity serves only as a mask to cover an essentially deregulatory drive which will give priority to the needs of employers over interests of employees. Flexicurity, as initially envisaged by the European Commission, was intended to replace a concern with job security with a focus on measures to enhance employment security. The evidence, however, suggests that the prevailing tendency in the EU is to reduce support for both. Apparent growth in current employment rates

conceals increasing recourse to precarious employment in the form of renewed fixed-term contracts, zero-hours contracts, bogus self-employment and involuntary part-time employment, failing to ensure workers decent living standards or enjoyment of their full rights at the workplace in the way it is defined by the International Labour Organisation. These precarious jobs are characterised by little or no job security owing to the non-permanent nature of the work, non-specific contractual terms or the absence of a written contract. For example, this can be seen in the case of involuntary part-time or temporary work or employment with unclear working hours and duties that vary in accordance with the employer's wishes, low remuneration, sometimes paid on an unofficial or undefined basis, little or no social protection or related entitlements, no protection against discrimination, little or no prospect of advancement in the labour market, little or no collective representation rights, and non-compliance with minimum health and safety standards in the workplace.

This situation has been further complicated by the fact that the social policy measures set out in Europe 2020 are weaker in terms of surveillance and enforcement than the new tools for tightening fiscal governance (Copeland, Haar, 2013, pp. 21-36; De Le Porte, Heins, 2015, pp.8-28.) and austerity has also meant that it has become more difficult to fund measures aimed at enhancing lifelong learning opportunities and improving social cohesion (Heins, De La Porte, 2015, pp.1-7; Bilić, 2017.). Social protection, such as unemployment benefits, and employment protection are being simultaneously weakened in many countries.

So, although the European Commission has emphasised that there are different national paths to flexicurity, does the concept of flexicurity continue to have significance for policy makers, employers and trade unions in a context of weakened welfare entitlements and employment rights? Does flexicurity need to be re-thought or simply abandoned? Is the solution nevertheless in the deregulation of labour legislation or in the adaptation of the concept of flexicurity with newly created conditions in the labour market? In answering these questions further research should be done, especially regarding efficiency and effectiveness of complete national flexicurity systems.

LITERATURE:

1. Algan, Y., Cahuc, P. (2004). Job Protection: the Macho Hypothesis, IZA DP no. 1192.
2. Nickel, L. (1999). Labour Market Institutions and Economic Performance, in: Ashenfelter and Card (Eds.), Handbook of Labour Economics.
3. Amable, B. (2003). The diversity of Modern Capitalism, Oxford University Press.
4. Anxo, D., O'Reilly, J. (2002). Working time transitions and transitional labour markets, in: Schmidt, G., Gazier, B., (eds.), The dynamics of full employment, Edward Elgar Publishing, Cheltenham.
5. Farnham, D., Horton, S. (1997). Human resource flexibilities in the United Kingdom's public services, Review of Personnel Administration, 1997.17(3):18-33.
6. Atkinson, J. (1984). Manpower Strategies for flexible organisations, Personnel management, August, 28-31.
7. Atkinson, J. (1985). Flexibility, Uncertainty and Manpower Management, report 89, Institute of Manpower Studies.
8. Atkinson, J. (1985). Flexibility : Planning for Uncertain Future, Manpower Policy and Practice, 1, Summer, p. 26-29.
9. Atkinson, J. (1987). Flexibility or fragmentation? :the United Kingdom Labour Market in the Eighties, Labour and Society, 12, 1, 87-215.
10. Bekker, S., Wilthagen, T. (2008). Flexicurity: a European approach to labour market policy, Intereconomics: Review of European Economic Policy, 43(2): 68-73, Springer Publishing.

11. Bilić, A. (2004). Ugovor o radu na određeno vrijeme - usklađivanje radnog zakonodavstva Republike Hrvatske sa propisima Europske unije, Zbornik radova Pravnog fakulteta u Splitu, 1; 167-18.
12. Bilić, A, (2010). Fleksibilnost i deregulacija u radnopravnim odnosima, doctoral thesys, Split
13. Bilić, A. (2011). Rad na daljinu prema međunarodnom, europskom i hrvatskom radnom zakonodavstvu, Zbornik radova Pravnog fakulteta u Splitu, str. 631.-647.
14. Bilić, A. (2014). Ravnopravnost spolova u kontekstu fleksibilnih oblika rada, u: Perspektive antidiskriminacijskog prava, Potočnjak, Ž., Grgurec, I., Grgić, A., (eds.), Pravni fakultet Sveučilišta u Zagrebu, Zagreb.
15. Bilić, A., Perkušić, T. (2016). Ugovor o radu na određeno vrijeme kao modus implementacije fleksibilnosti na tržištu rada, Mostariensia – časopis za društvene i humanističke znanosti Sveučilišta u Mostaru, str. 199-218.
16. Bilić, A., (2017a) Functional flexibility in the context of lifelong learning, (article will be published in serie Europeisation and globalisation, Springer edition)
17. Bilić, A. (2017b). Fleksibilno radno vrijeme – modus rekoncilijacije privatnog i poslovnog života radnika te povećanja kompetitivnosti poslodavca, (article will be published in Zbornik radova Pravnog fakulteta u Splitu, no.3)
18. Blanchard, O., Summers, L. (1986). Hysteresis and the European unemployment problem, in: Fisher, S. (ed.), Macroeconomics annual, Cambridge, Mass.: MIT Press, 15-78.
19. Bodiroga-Vukobrat, N. (2008). Tržišno natjecanje i socijalna sigurnost - europski zahtjevi i hrvatska iskustva, u Socijalna sigurnost i tržišno natjecanje – europski zahtjevi i nacionalna rješenja, Bodiroga-Vukobrat, N., (ur.), Rijeka, 2008:218.
20. Bodiroga-Vukobrat, N. (2002). Ist das Europäisches Sozialmodell auf die Transformationsstaten anwendbar?, in: Becken/Ruland/Steinmayer (eds.), Sozialrecht und Sozialpolitik in Deutchland und Europa, Festschrift für Bernd Baron von Maydel, Neuwiend, 51-61.
21. Bodiroga-Vukobrat, N. (2003). Posebnosti reforme socijalne sigurnosti, u: Von Maydel, B., Bodiroga-Vukobrat, N., Mirovinsko i zdravstveno osiguranje - nacionalne reforme u kontekstu europskih integracija, Rijeka,73 i dalje.
22. Calmfors, L. (1994). Active labour market policy and unemployment: A framework for the analysis of crucial design features, Paris:OECD Working papers.
23. Copeland, P., Haar, B. (2013). A toothless Bite? The effectiveness of the European Employment Strategy as a governance tool. Journal of European Social Policy, 21-36.
24. Council of the European union. (2009). Draft Joint Employment report (JER) 2009-2010. (Documents COM; (2009) 674, 15.12. 2009: https://www.eumonitor.eu/9353000/1/j4nvgs5kjg27kof_j9vvik7m1c3gyxp/vj6ipiy02ywx/f=/5037_10.pdf (accessed: 22. march 2016.).
25. Cridland, J. (1997). Flexible friend and foe, People management, 3(24) :21; F.
26. De La Porte, C., Heins, E. (2015). A new era of European Integration? Governance of labour market and social policy since the sovereign debt crisis. Comparative European Politics 13, 8-28.
27. De Vos, M. (2009). European flexicurity and globalisation: A critical perspective, International Journal of Comparative Labour Law and Industrial Relations, vol.25, no.3, 209-235.
28. Doeringer, P., Piore, M. (1971). International labour markets and manpower analysis, Lexington, Mass.: Health.
29. European commission. (1997). Green Paper, Partnership for a new organisation of work, Brussels, COM (97) 128.

30. European commission. (2006). Green Paper Modernising Labour Law to meet the Challenges of the 21 st Century, Brussels, COM(2006) 708 final.
31. European commission. (1993). White paper, Growth, Competitiveness and employment: the challenges and ways forward into the 21 st century, Brussels, COM(93) 700 final;
32. European commission. (2004). Employment in Europe, New skills and jobs in Europe: Pathways towards full employment, Brussels.
33. European commission. (2006). Employment in Europe 2006, Commission of the European communities, Luxemburg.
34. European commission. (2006). Annual progress report.
35. European commission. (2006). Flexicurity:combining flexibility and security, Social agenda, no.7, 2006:15.20.
36. European commission. (2007). Towards common principles of flexicurity: More and better jobs through flexibility and security, accesses at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0359:FIN:EN:PDF (accessed: 29. March 2017.).
37. Hancke, B., Rodhes, M., Thacher, M. (eds.). (2008). Beyond Varieties of Capitalism. Conflict, Contradictions and Complementaries in the European Economy, Oxford University Press.
38. Heins, E., De La Porte, C. (2015). The sovereign debt crisis, the EU and welfare state reform. Comparative European Politics, 13, 2015: 1-7.
39. Hunter, L., Mcgregor, A., Macinnes, J., Sproull, A. (1993). The "flexible firm": strategy, and segmentation, British Journal of Industrial Relations, 31, 1993:303.407.
40. International labour conference. (2001). Social security: issues, challenges and prospects (report VI), 89. session 2001:17-23.
41. Jackman, R., Layard, R., Nickell, S. (1996). Combating unemployment: is flexibility enough? In OECD Macroeconomic Policies and Structural Reform, Paris: OECD, 1996:19-49.
42. Jacobsen, K. (2004). Soft regulation and the subtle transformation of ststes: the case of EU employment policy, Journal of Employment Policy, vol.14 (4) 2004: 355-370.
43. Jepsen, M., Serrano Pascual, A. (2005). The European Social Model: an exercise in deconstruction, Journal of European Social policy, vol.15 (3) 2005:231-245.
44. Keune, M., Jepsen, M. (2007). Not balanced and hardly new: The European Commission's quest for flexicurity. In: Jørgensen, H., Madsen, PK (eds.), Flexicurity and beyond, Copenhagen: DJØRF Publishing.
45. Kok, W. (2004). Facing the challenge, 2004:33.
46. Laleta, S., Bilić, A., Barešić, A., New discourses in part-time work in the context of flexicurity, in: New developments in EU Labour Law and Human Rights Law, Vinković, M. (ed.), Osijek, 2015, p. 63-96.
47. Laleta, S., Bodiroga-Vukobrat, N. (2016). Fleksigurnost i (de)regulacija tržišta rada, Zbornik Pravnog fakuklteta Sveučilišta u Rijeci, vol.37, no.1, 2016:33-69.
48. Laleta, S. (2015). Rad putem agencija za privremeno zapošljavanje u hrvatskom, europskom i usporednom pravu, Zbornik Pravnog fakulteta Sveučilišta u Rijeci (1991) v. 36, br. 1, 305-340.
49. Monks, J. (2007). Stakeholder conference on flexicurity, Brussels. http://ec.europa.eu/employment_social/employment_strategy/pdf/flex_monks_en.pdf, accessed: 20. March 2017.
50. OECD, (2006). Jobs strategy: lessons from decade's experience, Paris,
51. OECD. (2006). Employment outlook. (http://www.oecd.org/document/38/0,3343,en_2649_33927_36261286_1_1_1_37457,00.html)

52. OECD. (2005). From unemployment to work.
53. Saint-Paul, G. (1998). A framework for analysing the political support for active labour martket policy, Journal of public economics, 67(1998): 151-65.
54. Saint-Paul, G. (1996). Exploring political economy of labour market institutions, Economic policy, 23, 1996:264-315.
55. Siebert, H. (1997). Labour Market Rigidities: At the Root of Unemployment in Europe, Journal of Economic Perspectives, 11, No.3, 37-54l.
56. Smith, V. (1997). New forms of work organisation, Annual Review of Sociology, 23, str. 315-339.
57. Streeck, W. (1991). On institutional conditions of diversified quality production. In: Matzner, E., Streeck, W.(eds.) Beyond Keynesianism. The socio-economics of production and full employment. Aldershot. Edward Elger, 1991:21-61
58. Tangian, A. (2005). Monitoring flexicurity policies in the EU with dedicated composite indicators, Conference of International Employment Relations Association, Denmark, Aalborg, 26−29 June 2005.
59. Tsakatita, M. (2005). Claims to legitimacy: the European Commission between continuity and change, Journal of Common Market Studies, , Vol.43, no.1, 2005:193-220.
60. Van Het Kaar, R., Grűnell, M. (2001). Variable pay in Europe, EIROnline.www.eurofound.europa.eu/eiro/2001/04/study/index.html
61. Wilthagen, T., Rogowski, R. (2002). The legal regulation of labour markets, u: Dynamics of full employment, Schmidt, G., Gazier, B.,(eds.), Edward Elgar, Cheltenham, 2002:250.
62. Wilthagen, T, Rogowski, R. (2014). The concept of flexicurity: a new approach to regulating employment and labour markets, Transfer, vol.21, no.2, 2004:169
63. Wilthagen, T., Tros, F. (2004). The concept of flexicurity: a new approach to regulating employment and labour markets, Transfer, 10, 2004:166-186.
64. World economics forum. (2014). Matching Skills and Labour Market Needs, Building Social Partnerships for Better Skills and Better Jobs, 2014. http://www3.weforum.org/docs/GAC/2014/WEF_GAC_Employment_MatchingSkillsLabourMarket_Report_2014.pdf (accessed:20. June 2016.).
65. Wilthagen, T., Tros, F. (2017). Dealing with the flexibility-security-nexus: Institutions, strategies, opportunities and barriers, AIAS working paper no 10, Amsterdam, Amsterdam institute for labour Studies, accessed at: www.uva-aias.net/uploaded files/publications/WP9.pdf (accessed: 29. March 2017.).
66. C ouncil recommendation 92/443/EEC of 27 July 1992 concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation), OJ L 245, 26.8.1992, p. 53–55.
67. Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC, OJ L 14, 20.1.1998, p. 9–14
68. Council Directive 1999/70/EC of 28 June 1999 concerning the framework agreement on fixed-term work concluded by ETUC, UNICE and CEEP, OJ L 175, 10.7.1999, p. 43–48
69. Directive 2008/104/EC of the European Parliament and of the Council of 19 November 2008 on temporary agency work, OJ L 327, 5.12.2008, p. 9–14
70. European Framework Agreement on Telework http://www.ueapme.com/docs/joint_position/Telework%20agreement.pdf

CRIMINAL OFFENCE OF TAX EVASION - THE EUROPEAN AND CROATIAN LEGAL FRAMEWORK

Damir Primorac
PhD, Associate Professor
Forensic Science Department at University of Split
Faculty of Law of University of Mostar, Lawyer, Republic of Croatia
damir.primorac@primorac-partners.com

Luka Pribisalic
Assistant at the Faculty of Law of University of Split
Republic of Croatia
luka.pribisalic@pravst.hr

Marko Pilic
MS of Forensic Science, Republic of Croatia
markopilic389@gmail.com

ABSTRACT

Tax evasion or tax avoidance is an omnipresent issue not only in the Republic of Croatia but also in all the Member States of the European Union. The diversity of legal frameworks does not help in the consolidation of the situation nor the reducing of tax evasion and tax avoidance. Identification of manifestation forms of tax evasion is the first step in solving the same issues and investing in new technologies, knowledge, and transparency is the important part of improving and maintaining the quality of any tax system. In this process, the importance of cooperation between the Member States lies within the new proposal for a package of measures against tax avoidance in economic operations in the European Union and the effort to improve tax transparency as well as prevention of aggressive tax planning. Strengthening tax treaties with third countries, which are not members of European Union, is of great importance in terms of tax avoidance in economic operations as well as developing efficient external strategy for effective taxation which would provide with consensual formulated obligations for Member States and from Member states to third countries in order to compliance with standards of transparency and automatic exchange of information for creating fair tax market.

Keywords**:** *case law of court of justice, efficient taxation, manifestation forms of tax evasion, tax avoidance, tax evasion*

1. INTRODUCTION

Taxes are forms of forced donation imposed by a country that has no direct counteraction, ie each country is not obliged to give the taxpayer something for the paid tax (Jurković, P., 2002, p. 250). Taxes have been introduced in ancient Egypt when they were the most prominent means of collecting the revenue needed to build, maintain or even run wars. In ancient Greece, the first tax imposts were fulfilled in various exceptional situations, which was not the case for slaves and perpetrators who were obliged to pay taxes constantly. On the other hand, the Roman Empire has begun to introduce more and more tax forms as a result of great financial needs. The outlines of current tax rates were already mentioned, such as sales tax and Customs taxes, consumption taxes and property taxes as well as other personal taxes (Jelčić, B., 2001, p. 34).

At the beginning of the 18th century, income tax evolutions were generated in England for funding the war against Napoleon and has served as an inspiration for various European countries for introducing it into its tax system (Jelčić, B., 2001, p. 223). Economic

development of the countries resulted in the introduction of new types of taxes as well as income taxes that at the beginning of the 20th century have their first forms. The United States introduced it in 1909 when it was 1%, and some European countries like Germany, Austria, England, and France after the First and Second World War. Given the history of tax evasion, evasion and avoidance of taxation have evolved. It is interesting to say that before the application of income tax to the state legal framework, tax evasion and tax avoidance were directed at Customs where bribes and counterfeit documents served as a means of achieving the goals of not paying taxes. Before entering the world of tax evasion and tax avoidance, it is necessary to explain in general terms the Croatian tax system (Croatian Tax System, 2016). We can divide it into 5 main groups:
(1) State tax (profit tax, value added tax, excise tax, income tax based on interest on savings)
(2) County taxes (inheritance and gift tax, road motor vehicle tax, boat tax, tax on entertainment machines)
(3) Taxes of local self-government units (surtax of income tax, consumption tax, holiday home tax, public property tax, real estate tax, real estate sales tax)
(4) Joint taxes (income tax, except income from income tax on interest on savings)
(5) Income tax on games of chance.

2. LEGAL FRAMEWORK

According to the Art. 256 par. 1 of the Criminal Code (in the text hereinafter: CC) of the Republic of Croatia (in the text hereinafter: RC) criminal offense of "Tax evasion and Customs" states that "Whoever, with intent that he or another person fully or partially avoid paying taxes or customs duties gives incorrect or incomplete data on income, objects or other factors that are influence on the determination of the amount of the tax or customs obligation or who, in the case of a mandatory application, do not report the income, subject or another fact that has an impact on the determination of tax or customs duties, and consequently reduces or not establishes Tax or Customs duties in excess of HRK 20,000.00 shall be punished by imprisonment for a term between six months and five years. The punishment referred to in paragraph 1 of this Article shall be imposed on whoever uses tax relief or customs benefit in the amount of more than HRK 20,000.00 if it is in contravention of the terms on which it was awarded. If the criminal offense referred to in paragraphs 1 and 2 of this Article has resulted in a reduction or non-determining of a large-scale tax liability, the perpetrator shall be punished by imprisonment for a term between 1 and 10 years. The provisions of paragraphs 1 and 3 of this Article shall also apply to a perpetrator who, in the acts described therein, reduces the funds of the European Union." It is important to highlight the diversity of the two terms we frequently encounter in the literature, which is divided by a thin line both in meaning and in statutory responsibility. Tax evasion and tax avoidance, although on a first look very similar, can actually make a big difference when it comes to legal responsibility. Tax avoidance can be defined as the taxpayer's actions by using marginal legal options in order to pay fewer taxes or be completely exempt from paying the same (Thuronyi, V., 2003, p. 156). On the other hand, tax evasion is defined as the activity of a taxpayer who directly violates the statutory provisions and results in the concealment of a tax liability and/or the payment of a lower tax than provided for by the law. Although both actions are reflected in the positive economic effects for taxpayers, they share another common denominator, which is intent (Matković, B., 2014, 98-100). When it comes to tax evasion, then there is an obvious intention to reduce or cover the obligations to the country, which, in tax avoidance, does not have to be the case. For example, let's take a certain mistake in entry books of company that resulted in a lower tax base, and therefore less tax paid. A person who works in the company's bookkeeping erroneously calculates one of the tax items and therefore the company pays a lower tax, and the person has no personal profit

except that he/she works for the salary. It must be taken into account that this person did not have any wrong intent to damage the country but is an misscalculation. On the other hand, if the person responsible for such a bookkeeping error is at the same time the owner of the company, then it takes into account any intention to illegally appropriate the money for his business and the case itself is otherwise appreciated. Such diversity of situations is reflected through the legal classification of the act, ie through the dilemma whether it is a misdemeanor or a criminal offense. In order to assess such a procedure as a criminal offense, apart from establishing a higher tax liability than the one mentioned above, it is necessary to ascertain the fact that the taxpayer (Matković, B., 2014, 98-100):
(1) It does not keep the business books or the same is not delivered to the tax administration,
(2) Does not have or does not display business documentation,
(3) Not available,
(4) If his tax liability is determined by an estimate based on the obtained documentation from other taxpayers or banks,
(5) If it is found that the business records or tax returns have false information.
All these conditions must be met in order for the act to take on the characteristics of the criminal offense. It is also necessary to establish the relationship between the taxpayer according to the calculation, reporting, and payment of tax liabilities, ie the difference between the unpaid tax amount, the period of the newly established tax liability, the fulfillment of the same obligations in earlier periods and the relation to the company's assets.

3. EMERGENT FORMS OF TAX EVASION

There are two basic modalities that we can classify as a tax evasion (Jelčić, B., Lončarić-Horvat, O., Šimović, J., Arbutina, H., 2002, p. 197), a to su:
(1)Complete tax evasion,
(2)Partial tax evasion.
A complete tax evasion is considered a case where a taxpayer does not report the total amount of income that should be taxed. The same group also covers the concealment of possession of property that, as such, is to be taxed. After all, any conscious taxpayer's actions in concealing particular data that are important for taxation can be considered as total tax evasion. Partial tax evasion is considered incomplete or false tax statement about the amount of total income, the value of the existing property or a false statement of facts or effects that are important for determining the amount of tax resulting in a reduction in the tax liability (Marković, B., 2000, p. 283). There is no negligible contribution of gray economy (Lovrinčević, Ž., Marić, Z., Mikulić, D., 2006, p. 30-65) in the economic situation, the most common form of tax evasion is the payment of part of the salary to the employee, ie the employee applies to the legal minimum wage and the rest of the agreed amount is given in cash "on hand". Despite the above-mentioned situations within a complete or partial tax evasion it is important to emphasize the most common forms of violation of tax laws:
-Failure or improper submission of annual reports,
-Not issuing receipts,
-Not paying the required tax to the appropriate account,
-Incorrect determination of the tax base,
-Utilization of tax relief and exemption contrary to law,
-Incorrect tax calculation,
-Non-keeping of documentation,
-Denial of supervision,
-Failure to do inventory within the given time limit.

3.1. MEASURES TO PREVENT TAX EVASION

The identification of the cause of the tax evasion and the gradual reduction is more important than just acting on the consequences of tax evasion. Also, the causes of tax evasion should be appropriately divided according to the causes and the ways of occurrence and in that direction apply mitigation measures. By categorizing the measures and causes, special emphasis is placed on institutional, legal and socio-economic measures. As the most important institutional methods for reducing tax evasion, it is important for taxpayers to trust in those who adopt and implement such measures, which can be acquired solely and exclusively by the same approach and relationship with all taxpayers, both physical and legal entities. Efficiency and transparency of tax administration are just one part of a quality tax system, putting in the first place the expertise of the persons doing the job and their constant education to keep up to date with the latest technologies and knowledge (Kesner-Škreb, M., 2007, p. 5). It is also a fact that taxpayers will be more responsive to tax revenues and controls when same rules applies to everyone, when tax money is spent rationally and fairly and when the effectiveness of legal protection is at a higher level (Šimović, J., Rogić Lugarić, T., Cindori, S., 2007, p. 604). When it comes to legal measures to prevent tax evasion, the consistency of legal regulations is perhaps the most important segment because frequent changes put uncertainty into taxpayers and companies, and thus also potentiates economic instability. What surely imposes as a potent weapon in the fight against tax evasion is punishment of imprisonment, extremely high fines, and a prohibition of engaging in occupation within which tax evasion and confiscation of the defrauded amount (Jelčić, B., Lončarić-Horvat, O., Šimović, J., Arbutina, H., 2002, p. 197). It is important to emphasize when legal measures are concerned, equal treatment for everyone. The socio-economic reason for tax evasion definitely raises the question of the fairness of the tax burden distribution, especially if we look at the constitutional principle in Art. 3 of Constitution of RC with equality and fairness statements and tax assessment of equality between the equals and diversity among the different. If all the potential measures to prevent tax evasion and avoidance of tax payments have been classified into several major steps, either global measures or individually for each country (Mathiason, N., 2012), then we would emphasize the following steps:

(1) Multilateral automated exchange of key data for tax determination,
(2) Public disclosure of known beneficiaries of various companies, foundations or groups,
(3) Global intercountry reporting,
(4) Joint international action for the purpose of identifying, controlling and reducing the artificial inflow of company costs and reducing profits through transactions carried out within the company,
(5) Harmonization and codification of the law on money laundering.

Some changes have recently occurred, notably by highlighting an agreement to improve tax transparency between RC and the United States. ”Application of foreign account tax compliance Act – (FACTA)” Requires a foreign financial institution to report once a year to the US Internal Revenue Service (IRS) information on the assets of US citizens who have, in this case, in RC, and the IRS will do the same and inform the Croatian tax administration of property and accounts held by Croatian citizens in America (Croatia Week magazine, 2015).
Progress is also evident in the situation of the law on fiscalization, which was presented in early 2013. The law primarily targeted bars and restaurants, and the Tax Administration has published statistical data where, only in one year Croatian restaurants, cafes and retailers

increased their revenues by 1 billion euros, an increase of 17% compared to the previous year (Croatia Week magazine, 2014).

4. COURT DECISIONS AND CASES IN PRACTICE

In court practice, we often encounter interesting cases that provide a deeper insight into the application of the law, as well as the diversity of situations that can be encountered.
In the following, we will give a few examples. In the first case, the person is charged with the criminal offenses of tax evasion or customs duties referred to in Art. 256 par.1 CC, which includes tax evasion in a period of 2 years, specifically for 2005 and 2006, in the total amount of HRK 23,008.00. The Financial accounting expert determines that for the first year the amount is in HRK 14,509.60, and for the second year the remaining amount of HRK 8,498.40 which the court of the first instance, based on the expert's findings, accepts. However, in order to achieve a criminal offense, in all its essential features, it is necessary to deduct an amount greater than HRK 20,000.00 within one fiscal year, which is not the case here but is a two-year period. No essential features of the criminal offense have been achieved and the person can not be charged for the same thing. It is also important to emphasize that in the opinion of this Appellate Court there can not be another procedure because of the difference in the way of determining the unpaid tax if one has been accused in the misdemeanor proceedings for the same offense (Supreme Court of Republic of Croatia, 2015).

In the second example, it is important to state first that according to Art. 2 par.1 of the General Tax Code of RC (Opći porezni zakon Republike Hrvatske, in the text hereinafter: GTC - RC) public debts are taxes and other public grants, and in accordance with Art. 3 of the same Article are: excise duties, customs duties, fees, concession fees, contributions, fines for offenses as well as all other charges whose determination, collection and supervision are within the jurisdiction of the tax authority. In this particular case, a person is charged with committing a criminal offense under Art. 256 par. 1 of the CC by avoiding the payment of income tax on non-employment and the contribution of health and pension insurance in the event of an injury at work and all of the wages of a total of eight employees, thereby damaging the state budget in the amount from 58.643,96 kn. However, financial expertise has determined that a person does not exceed the total tax liability of HRK 20,000.00 since all of these contributions and benefits do not fall into the criminal offense referred to in Art. 256 of CC, and therefore do not constitute a criminal offense. For this reason, the first-instance court acquitted the person of the charges under Art. 354 par. 1 of the Code of Criminal Procedure of Republic of Croatia (in the text hereinafter: CPC - RC), because the act that is charged is not a criminal offense (County Court in Rijeka, 2014). In practice, it is not uncommon to change the law before the conclusion of court proceedings and the passing of a final verdict.

According to the author (Garačić, A., 2013, p. 255-256), this is the case in the following example: *“ After the verdict was issued on 1 January 2013. The CC/11 has ceased to exist and bearing in mind that circumstance and provision of Art. 3 par. 2 and 3 CC/08, since the criminal offense referred to in Art. 292. par. 1. al. 4. in conjunction with par. 2 of the CC / 97, it was no longer foreseen in the CC as a criminal offense, and it was necessary to establish whether the factual situation that was established could be attributed to a criminal offense under the new CC, and it was established that this factual description Can be found under the criminal offense of Impairment of Taxes and Customs Offenses referred to in Art. 256 par. 3 and 1 of CC/11 because there is legal continuity between these acts in relation to the established factual description. However, for the criminal offense referred to in Art. 292 par. 2 of the CC/97 is punishable by a prison sentence of 1 to 8 years, and for the criminal offense referred to in Art. 256 par. 3 and 1 of the CC/11 is punishable by imprisonment of 1*

to 10 years, but the new CC/11 is more favorable to the perpetrator because according to the legal understanding of the Criminal Division of the Supreme Court of Croatia, dated 27 December 2012. The legal character defining Indefinite values as large tax liabilities under Art. 256 par. 3 of the CC/11 is determined with an amount of HRK 600,000.00, while those legal elements have a significant amount of material gain from Art. 292 par. 2 of the CC/97, according to the previous legal opinion of the Supreme Court, was in the amount exceeding HRK 30,000.00. Thus, the property census is increased which makes the work a qualifying one, and so the new law, regardless of the one-to-ten-year sentence, for the perpetrator is favorable than the old CC/ 97, because in order to commit the qualified aspect of this criminal offense it is necessary the perpetrator obtains greater property gain in the amount of HRK 600,000.00, while in this area of the qualified criminal offense he entered the already acquired benefit with a value of HRK 30,000.00. At the same time, the specific punishment must not exceed the scope of the punishment for the criminal offense referred to in Art. 292 par. 2 of CC/97."(County Court in Šibenik, 2015).

5. PACKAGE OF MEASURES AGAINST TAX AVOIDANCE IN ECONOMIC OPERATIONS IN EUROPEAN UNION

The European Commission has put forward a package of measures to avoid tax evasion in economic operations containing concrete measures for fairer, simpler and more efficient taxation of companies in the European Union (in the text hereinafter: EU) and measures to prevent aggressive tax planning as well as improve tax transparency and market equilibrium for all companies in EU. With these measures, a firm and coordinated action against avoidance of taxes and securing the conditions for companies to pay taxes regardless of their country's EU profitability is planned. The package of measures is envisaged on different and separate levels of implementation and control measures.

Figure 1. Anti tax avoidance package
(Communication from the Commission to the EU Parliament and Council, 2016)

5.1. Chapeau communication

Chapeau communication is the communication of the highest instances within the EU, namely the Commission and the European Parliament and the Council. Emphasis has been placed on fairer and more efficient taxation of the profits of the company and the uniqueness and equity of the market based on the principle that companies are paying taxes in the country in which they earn profits (Action plan for fair and efficient corporate taxation in EU, 2015). *"This principle is endangered by aggressive tax planning. Most companies do not apply aggressive tax planning and therefore have unfavorable market positions in relation to companies that apply it. Aggressive behavior of these companies is damaging price signals*

and allowing them to lower capital costs that undermine equality of conditions in the single market. This phenomenon particularly affects small and medium enterprises. A coordinated approach to tax systems implementation that is conducive to growth and elimination of cross-border problems is of key importance for a fully functional single market, a successful union of capital markets and attracting EU investment. "(Communication from the Commission to the European Parliament and Council (2016).

Anti-Tax avoidance package: Next steps towards delivering effective taxation and greater tax transparency in the EU, 2016). Member States are now aware of this and are demanding to stop aggressive tax planning (Zaključci Vijeća o oporezivanju trgovačkih društava- smanjenje porezne osnovice i prijenos dobiti, 2015).

5.2. The proposal of the directive against tax avoidance

In the proposal of the directive, several legally binding measures against abuses and aggressive tax planning were introduced:
(1)Rule of control of foreign companies with the purpose of halting the transfer of profit to a country with little or no tax,
(2)The Switchover Rule - Prevention of double non-taxation of certain revenues,
(3)Outbound taxation - avoiding the avoidance of taxation of companies moving property,
(4)Interest restrictions - to prevent the creation of artificial debt for the purpose of minimizing taxes,
(5)GAAR (general anti-abuse rule) - as a way to fight aggressive tax planning, when other rules can not be applied.
These measures aim to create a degree of protection against corporate tax evasion within the EU and thus create a stable business environment (The anti-tax avoidance Directive, 2016).

5.3. The revision of administrative corporate directive

In the context of the Council's proposal for amending the already existing Directive 2011/16/ EU and included in the measures to prevent tax evasion, it aims to set a political priority in the fight against tax avoidance and aggressive tax planning. In order for this system to fulfill its purpose, comprehensive and relevant information in interstate communications is needed, so that multinational companies do not have the obligation to provide information to all EU Member States where they are operating only to resident and its tax authorities, and after the receipt of the report the resident county would share the information with all EU member states where the company is subject to tax due to doing business in a permanent business unit. Regardless of the fact that cooperation between the EU Member States is envisaged in EU legislation and a set of information exchange measures, cooperation needs to be continued to ensure the proper functioning of the EU market (Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, 2016, p. 4).

5.4. Proposal on tax treaties

This proposal advises EU member states to strengthen tax arrangements against aggressive tax planning but in accordance with EU legislation (Commission recommendation on the implementation of measures against tax treaty abuse, 2016, p. 2-4). The idea of the European Commission is based on the understanding of current tax agreements where the group opens its subsidiaries in other countries and then the subsidiary pays dividends to the parent group and according to the tax treaty between these two countries taxes are paid. The most common case is that the groups open up branches in one of the EU Member States and in third non-EU countries, and have a tax agreement from both countries, resulting in a possibility of non-

payment of taxes. The Commission's proposal is that in case the new businesses do not present a true economic activity, the state is not required to apply a tax treaty and thus ensure that tax treaties are not misused and tax liabilities are also enforced.

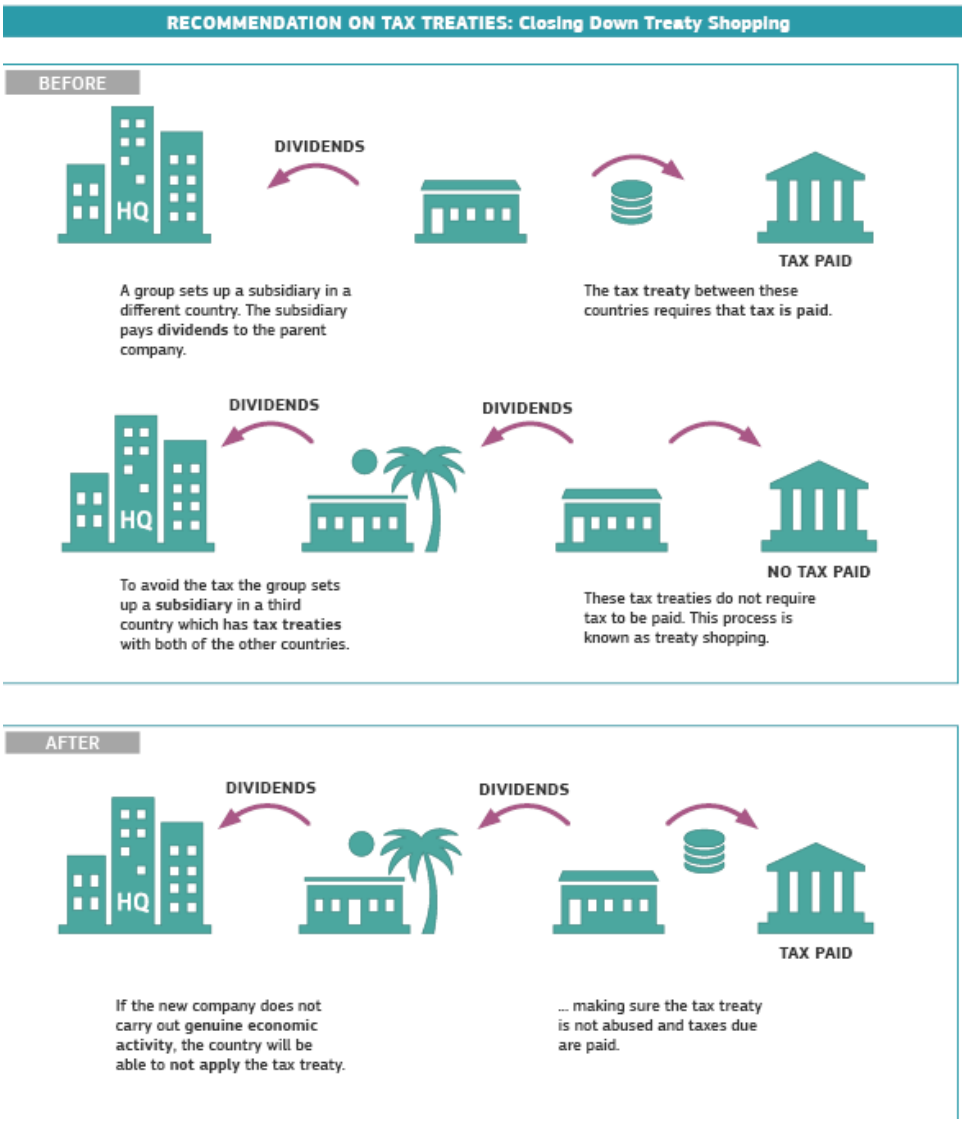


Figure 2. Closing down on treaty shopping
(Recomendation on Tax treaties, 2016)

5.5. The communication on an external strategy for effective taxation

It is quite clear that the EU's position must be unique when it comes to international taxation systems and a more firm and firm stance in the fight against tax evasion through various tax havens (Report with recommendations to the Commission on bringing transparency, coordination and convergence to Corporate Tax policies in the Union, 2015, p. 25). At this point, national measures to avoid tax evasion are significantly different and the only taxation in relation to third countries is solved, leading to the establishment of a common external strategy on harmonized, clear and internationally recognized criteria in the taxation system and consistency of application to third countries. Increased tax transparency as one of the key elements in the international taxation system has been identified through the Organization for Economic Cooperation and Development (OECD), but until complete implementation will reach no later than 2018 when the latest deadline for the implementation of a new information exchange standard (Automatic Exchange of Financial Account Information,

2016, p. 3). The EU has also concluded information exchange agreements with Liechtenstein, San Marino and Switzerland, and is still in agreement with Monaco and Andorra. Also, bilateral and regional agreements with third countries provide an opportunity for a consensual formulation of each party's commitment to respect the standards of transparency and information exchange, which will ensure the inclusion of tax policy priorities towards third countries. The EU must, among other things, strengthen instruments in response to third countries refusing to respect established standards in the field of taxation. This process is designed in 3 steps:
(1)Identification of third countries to be monitored by a neutral observer,
(2)The Member States shall decide which of these States shall be monitored
(3)The Commission proposes countries which should be placed on the list of "offenders" and The Member States make a final decision. The moment the third country meets the already agreed standards, it will be removed from the list.
Such a list at EU level is a temporary solution for the purpose of establishing a common system for assessment and verification of third countries that will ultimately replace the unified standards for third countries that fail to comply with a good governance agreement (Communication from the Commission to the European Parliament and the Council on an External strategy for effective taxation, 2016, p. 3-6).

6. CONCLUSION

Tax evasion or tax avoidance is an omnipresent issue not only in the Republic of Croatia but also in all EU Member States. The variety of legislative frameworks between countries does not help consolidate the situation and reduce the evasion and avoidance of tax payments. A full tax evasion is considered a case where a taxpayer does not report the total amount of income that should be taxed. The same group also covers the concealment of possession of property that, as such, is to be taxed. After all, any conscious taxpayer's actions in concealing particular data that are important for taxation can be considered as total tax evasion. Partial tax evasion is considered incomplete or false tax statement of the amount of total income, the value of the existing property or a false statement of facts or effects that are important for determining the amount of tax resulting in a reduction in the tax liability. It is not negligible either the contribution of the gray economy to the economic situation, and the most common form of tax evasion is the payment of part of the employee's salary, ie the employee applies for the legal minimum wage and the rest of the agreed amount in cash "on hand". Given that this is a direct violation of the legal framework, the country has a clearer way of action than tax evasion, where it is in principle the offense of the taxpayer but still within the law. Even greater difficulties are encountered in the economic activity of entities in the area of several EU Member States and greater tax evasion opportunities due to legal imbalances in the several Member States as well as in third countries. Transparency, automatic exchange of information and alignment of the legal framework among the EU Member States are key to stopping development of the tax avoidance trend and can equally be applied from European directives to domestic legislation.

LITERATURE:

1. Action plan for fair and efficient corporate taxation in EU, (2015), accessed on May 15, 2017 at: http://europa.eu/rapid/press-release_IP-15-5188_hr.htm
2. Automatic Exchange of Financial Account Information, (2016), p. 3, accessed on May 15, 2017 at: http://www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf

3. Commission recommendation on the implementation of measures against tax treaty abuse, Bruxelles, (2016), p. 2-4, accessed on May 15, 2017 at: http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/anti_tax_avoidance/c_2016_271_en.pdf
4. The anti-tax avoidance Directive, (2016), accessed on May 10, 2017 at: http://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en
5. Garačić, A., (2013). Novi kazneni zakon, Organizator, Zagreb, p. 255 - 256.
6. Lovrinčević, Ž., Marić, Z., Mikulić, D. (2006). Maastrichtski kriteriji i uključivanje sive ekonomije – slučaj Hrvatska, Privredna kretanja i ekonomska politika, br.106, p. 30 - 65.
7. Jelčić, B., (2001). Javne financije, RRiFPlus, Zagreb, p. 34 – 223.
8. Jelčić, B., Lončarić-Horvat, O., Šimović, J., Arbutina, H. (2002). *Financijsko pravo i financijska znanost*, Narodne novine, Zagreb, p. 197.
9. Jurković, P. (2002). Javne financije, Masmedia, Zagreb, p. 250.
10. Kazneni zakon Republike Hrvatske (Narodne novine 125/11, 144/12, 56/15, 61/15)
11. Kesner-Škreb, M., (2007). Što s porezima u Hrvatskoj? Porezno opterećenje, oporezivanje dohotka, dobiti i imovine, Newsletter, br. 32., accessed on May 14, 2017 at: http://www.ijf.hr/newsletter/32.pdf
12. Communication from the Commission to the European Parliament and Council (2016). Anti-Tax avoidance package: Next steps towards delivering effective taxation and greater tax transparency in the EU, Bruxelles, accessed on May 14, 2017 at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0023&from=EN
13. Communication from the Commission to the European Parliament and the Council on an External strategy for effective taxation, (2016), Bruxelles, p. 3-6 accessed on May 14, 2017 at: http://eur-lex.europa.eu/resource.html?uri=cellar:b5aef3db-c5a7-11e5-a4b5-01aa75ed71a1.0018.02/DOC_1&format=PDF
14. Marković, B. (2000). Pojava porezne evazije kod oporezivanja poduzetnika u Republici Hrvatskoj, Zbornik radova: Tendencije u razvoju financijske aktivnosti države, Zagreb, p. 283.
15. Mathiason, N. (2012). Five steps to end global tax evasion, accessed on May 15, 2017 at: https://www.theguardian.com/commentisfree/2012/jan/24/five-steps-global-tax-evasion
16. Matković, B. (2014). Prekršajna i kaznena odgovornost za neplaćanje poreza i carine, p. 98-100, accessed on May 15, 2017 at:
17. http://www.racunovodstvo-porezi.hr/sites/default/files/casopisprivitak/ripup14-04-098.pdf,
18. Ministarstvo financija republike Hrvatske, Porezna Uprava (2016). Hrvatski porezni sustav, Zagreb, accessed on April 20, 2017 at: https://www.porezna-uprava.hr/HR_porezni_sustav/Stranice/naslovna_tablica_psrh.aspx
19. Decision of Supreme Court of Republic of Croatia (2015). I Kž-647/13.
20. Decision of County Court in Rijeka (2014). Kž-588/13-4.
21. Decision of County Court in Šibenik (2015). Kž-225/12.
22. Online magazine CroatiaWeek (2015). Croatia and United States sign tax evasion prevention agreement, accessed on April 22, 2017 at: http://www.croatiaweek.com/croatia-and-united-states-sign-tax-evasion-prevention-agreement/
23. Online magazine CroatiaWeek (2014). Over 1 Billion € more declared since fiscal cash registers became law in Croatia, accessed on April 22, 2017 at: http://www.croatiaweek.com/over-e1-billion-more-declared-since-fiscal-cash-registers-became-law-in-croatia/
24. Opći porezni zakon Republike Hrvatske (Narodne novine 115/16)

25. Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (2016). Bruxelles, p. 4, accessed on May 15,2017 at: http://eur-lex.europa.eu/legal-content/HR/TXT/PDF/?uri=CELEX:52016PC0025&from=EN
26. Report with recommendations to the Commission on bringing transparency, coordination and convergence to Corporate Tax policies in the Union, (2015). p. 25, accessed on May 15,2017 at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A8-2015-0349+0+DOC+PDF+V0//EN
27. Šimović, J., Rogić Lugarić, T., Cindori, S. (2007). Utaja poreza u Republici Hrvatskoj i mjere za njezino sprječavanje, p. 604, accessed on May 14, 2017 at: http://hrcak.srce.hr/89297.
28. Thuronyi, V. (2003). Comparative Tax Law, Kluwer Law, p. 156.
29. Ustav Republike Hrvatske, (Narodne novine br. 56/90, 135/97, 8/98, 113/00, 124,00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14)
30. Zaključci Vijeća o oporezivanju trgovačkih društava- smanjenje porezne osnovice i prijenos dobiti, (2015). accessed on May 15, 2017 at: http://www.consilium.europa.eu/hr/press/press-releases/2015/12/08-ecofin-conclusions-corporate-taxation/
31. Zakon o financiranju jedinica lokalne i područne (regionalne) samouprave (Narodne Novine br. 117/93, 33/00, 73/00, 59/01, 107/01, 117/01, 150/02, 147/03, 132/06, 26/07 – Odluka USRH, 73/08, 25/12, 147/14, 100/15 i 115/16).
32. Zakon o kaznenom postupku (Narodne novine br. 152/08, 76/09, 80/11, 121/11, 91/12, 143/12, 56/13, 145/13, 152/14)
33. Zakon o lokalnim porezima (Narodne Novine br. 115/16)

NON-OBSERVANCE OF GENERAL PRINCIPLES IN PUBLIC PROCUREMENT IN LIGHT OF RECENT CASE LAW

Jana Janderova
University of Pardubice, Faculty of economics and public administration, the Czech Republic
jana.janderova@upce.cz

Michaela Havelkova
University of Pardubice, Faculty of economics and public administration, the Czech Republic

ABSTRACT

Treaty on Functioning of EU does not offer any specific provisions relating to public procurement. However, it contains general principles that need to be obeyed. In particular, the principle of transparency, non-discrimination, equal treatment and proportionality. When these general principles expressed in the Treaty on the Functioning of the EU and in public procurement directives are violated, it happens in an indirect manner, which at first glance is not a flagrant violation of any of the provisions of the Treaty. The paper analyses recent case law of the Court of Justice of the EU. It further studies the approach of the Czech administrative courts and compares it with the one of Court of Justice of the EU. Results of the analysis are synthesized and deviations found in the comparative part are exposed. The paper also summarizes the most common causes of violation of the general principles which render public contracts invalid.

Keywords: *Court of Justice of the EU, General principles, Non-discrimination, Proportionality, Public procurement, Transparency*

1. INTRODUCTION

Public procurement is regulated by the European Union in all its Member States in order to facilitate creation of a single market and promote competition. Both general principles in the Treaty on the Functioning of the EU (TFEU) and detailed secondary legislation in the form of procurement directives, which set out award procedures for major contracts, apply to public procurement. The principles, which flow from this procurement legislation, in particular, the principle of transparency, non-discrimination, equal treatment and proportionality, are binding on the contracting authorities and their breach will result in invalidity of a contract entered into as a result of defective public procurement procedure. Contrarily, EU measures are not intended to lay down how member States should achieve value for money or integrity in public procurement, which are matters for Member States to determine in their national legislative measures. (Arrowsmith, 2006; p. 340) As to the extent, to which they wish to adopt such rules seeking to assure wise spending of public money, Member States are left with a certain margin of discretion. However, the Court of Justice of the EU has in the past twenty five years heavily curtailed this freedom of regulation through the application of the general principles of equal treatment and transparency. (De Mars, 2013; p. 318)

The Court's approach of teleological interpretation of the TFEU, of using general principles as a regulatory means, and the case law being rather fragmented and vague leaves Member States with substantial legal uncertainty. The specific obligations that stem from the jurisprudence are not always clear. For this, but also other reasons, Member States sometimes choose to apply rules and principles of EU procurement law even to matters for which they are not required to do so – for public contracts which fall short of the thresholds set by the public procurement directives. Those are often rather demanding on procurement authorities as they create many formal obligations. On the other hand, these developments tend to increase the degree of harmonization among Member States, which is positive.

This article seeks to demonstrate the nature of the general principles governing public procurement and common conducts that infringe these principles through analyses of relevant case law of the Court of Justice of the EU and the administrative courts of the Czech Republic. Although, the available case law deals with directives which have been made ineffective by new directives which were to be transposed by April 2016, valid conclusions may be drawn from it, because the principals stay the same as they were in the replaced directives. Most common causes of violation of the general principles are summarised as a result of the analyses. Further, Czech national case law is compared to the case law of the Court of Justice of the EU and deviations are stressed.

2. EU LEGISLATION GOVERNING PUBLIC PROCUREMENT

EU public procurement measures, since they specifically concern public service contracts, are intended to ensure the free movement of goods and services and the opening-up of undistorted and as broadly as possible competition in the Member States (see Bayerischer Rundfunk and Others, C 337/06, paragraph 39 and the case-law cited). The TFEU does not contain any specific provisions on the award of public contracts, but it regulates the principles applicable to public procurement within the EU. Member States must ensure that the principles as stipulated by the TFEU are respected. These are the principles of transparency, and equal treatment, which follow from the principles of the free movement of goods and services, right of establishment and mutual recognition of qualification. They may be drawn from Articles 18 TFEU, 34 TFEU, 49 TFEU and 56 TFEU. These provisions prescribe that contracting authorities may not discriminate against bids and bidders from other EU Member States (including goods that were already imported to EU). They apply to all public contracts, provided that those have a certain cross- border interest in the light if its value and the place where they are carried out, even to those that do not come within the scope of the public procurement directives, as they fall short of the relevant threshold laid down in the particular directive, as will be mentioned later. The original EC procurement regime had very much of a framework character. It laid down a limited body of rules on key issues, and left considerable discretion to Member States to supplement these with their own national procurement laws. However, EU law has moved significantly away from its original framework character in the direction of a system of common rules. Originally, it was thought that the Treaty created only negative obligations, as to what behaviour is forbidden, which needed to be supplemented by positive obligations contained in directives covering public procurement. However, in 1993 Court of Justice of the EU changed this understanding by inferring first two general principles and used those to imply positive obligations beyond those stated in the directives on Member States. At the same time, the Court made it clear, that States do not need to implement these obligations to their national laws; however they need to assure that the principles are not breached. Public procurement directives[1], on the other hand, abound with positive obligations laid on the states which need to be transposed. The specific rules contained in the directives deal with how the public contracts need to be advertised, types of awarding procedures and their course, on what basis a public contract may be awarded, and so on. However, these rules apply only to major contracts, as the

[1] The three most important public procurement directives date from 2014 were to be transposed by 18 April 2016. They have replaced directives from 2004 and cover both public sector (government or public bodies whether at federal, state, regional, or local/municipal level) and the utilities sector (water suppliers, energy, transport and postal services). Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014, on the award of concession contracts; Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014, on public procurement and repealing Directive 2004/18/EC; and Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014, on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC.

directives set financial thresholds under which the contracts are deemed to be not capable of distorting cross-border competition. The directives stress four essential procurement principles which are contained in Art. 18 of the Public Sector Directive, and Art. 36 of the Utilities Directive, which both stipulate that contracting authorities shall treat economic operators equally and without discrimination and shall act in a transparent and proportionate manner. The design of the procurement shall not be made with the intention of excluding it from the scope of Directives or of artificially narrowing competition. Competition shall be considered to be artificially narrowed where the design of the procurement is made with the intention of unduly favouring or disadvantaging certain economic operators. Both directives add further principles aimed at protection of environment, and compliance with EU social and labour law provisions.[2]

3. CZECH LEGISLATION GOVERNING PUBLIC PROCUREMENT

New law, Act No. 134/2016 Coll., On Public Procurement (further in the text referred to as the "Act" only), came into force on 1st October 2016. It has replaced in full Act No. 137/2006 Coll., On Public Contracts. The new law was adopted in response to three new European Union Directives, mentioned above. The act builds on some aspects of the original Act on Public Contracts, but in many respects the concept of the new law is different, introducing into the Czech legal order also some of the previously unknown and unused public procurement institutes. The principles explicitly mentioned by the Czech public procurement law are definitely inspired by EU law. They are defined in Sec. 6 of the Act. The principle of transparency, proportionality, equal treatment, and non-discrimination are followed by contracting authority's obligation not to restrict participation in the procurement procedure to those suppliers established in (a) a Member State of the European Union, the European Economic Area or the Swiss Confederation; (b) another State which has an international treaty with the Czech Republic or with the European Union guaranteeing the access of suppliers of these States to a public contract. The second group of not expressly mentioned principles, but still applicable ones, consists of 3E principles (economy, efficiency, and effectiveness of the money spent), and other principles resulting from the nature of public contracts and its aim to find the best value for money which comes from public budgets. These principles are contained in other laws in relation to the spending of public funds for the award of the contract. However, they are often neglected because the contracting authorities are not sure to link these principles to the Act. Other principles include, for example, ensuring the cost-effective management of public funds, promoting competitive environment, the principle of formality of the award procedure.

4. INDIVIDUAL PRINCIPLES

Analysis of individual principles appearing both in the EU directives and the Czech Act together with the comparison of the Court of Justice approach and the approach of the Czech administrative courts will be carried out in this chapter. The intention is to indicate differences in interpretation and application of the principles, if any. Further, the level of inspiration of the Czech courts by the case law of the Court of Justice is to be assessed.

[2] Art. 18 par. 2 of the Public Sector Directive reads as follows. Member States shall take appropriate measures to ensure that in the performance of public contracts economic operators comply with applicable obligations in the fields of environmental, social and labour law established by Union law, national law, collective agreements or by the international environmental, social and labour law provisions (listed in Annex X of the directive).

4.1. Equal treatment

The principle of equal treatment can be understood as the obligation of the contracting authority to approach all tenderers, perhaps any interested parties, in the same way during the tender procedure. Equal treatment of individual tenderers means such acting of the contracting entity, whereby the same, unfavourable approach to all economic operators is ensured, i.e. equal opportunities are ensured. In Fabricom[3] the Court of Justice defined conditions of equal treatment as: "comparable situations must not be treated differently and different situations must not be treated in the same way, unless such treatment is objectively justified". The contracting entity is to be neutral towards all tenderers. It is therefore totally inadmissible to provide, for example, more information on the subject of a public contract to a selected tenderer or group of tenderers. Together with the principle of transparency the principle of equal treatment precludes, following the award of a public contract, the contracting authority and the successful tenderer from amending the provisions of that contract in such a way that those provisions differ materially in character from those of the original contract. Such is the case if the amendments either extend the scope of the contract to encompass elements not initially covered or to change the economic balance of the contract in favour of the successful tenderer, or those changes are liable to call into question the award of the contract, in the sense that, had such amendments been incorporated in the documents which had governed the original contract award procedure, either another tender would have been accepted or other tenderers might have been admitted to that procedure. (Case C-454/06 of 19 June 2008, par. 34 to 37) In principle, a substantial amendment of a contract after it has been awarded must give rise to a new award procedure for the contract so amended. It may be effected by direct agreement between the contracting authority and the successful tenderer if such amendment had been provided for by the terms of the original contract. Recent example of the breadth of this principle is Finn Frogne.[4] "Following the award of a public contract a material amendment cannot be made to that contract without a new tendering procedure being initiated even in the case where the amendment is, objectively, a type of settlement agreement, with both parties agreeing to mutual waivers, designed to bring an end to a dispute the outcome of which is uncertain, which arose from difficulties encountered in the performance of that contract." (Case C-549/14 of 7 September 2016, par. 40). As for the Czech case law, the importance of this principle was highlighted by the Supreme Administrative Court in its judgment of 12 May 2008, ref. No. 5 Afs 131/2007 - 132, where it judged, "... this principle contains equality of opportunities for all tenderers and the contracting authority must observe it in every stage of the awarding procedure. Its objective is to promote the development of healthy and effective competition between the entities involved in the procurement procedure and therefore requires all tenderers to have the same opportunities in formulating their tender bids. It is therefore assumed that all competitors need to be subject to the same conditions." Equal treatment principle is manifested in many specific provisions of the Act. For example, when completing or clarifying data, documents, samples or models pursuant to Sec. 46 of the Act, it can be inferred that the contracting authority should, if it chooses to use its right in the award procedure, to use this institute equally in relation to all contractors. Another example of a breach of equal treatment of all tenderers was found by the Regional Court in Brno in its judgment of 16 March 2011, ref. No. Ca 29/2009, in a situation: "...when the contracting authority sets absolutely disproportionate requirements to prove the fulfilment of qualification, by which it purposefully and in contravention of the law limits the participation of a certain group of potential suppliers. The contracting authority is entitled to avail itself of the space provided

[3] Fabricom v Etat Belge (C-21/03 and C-34/03)
[4] Finn Frogne A/S v Rigspolitiet ved Center for Beredskabskommunikation (C-549/14) of 7 September 2016

by law, and thus create a disadvantage for certain potential suppliers through imposing specific level of economic and financial qualifications or technical qualification prerequisites, provided that it is justified by objective circumstances and the requirements of the contracting authority are not disproportionate." However, it is not contrary to equal treatment principle, if the same entity processes part or the entire tendering specifications (e.g. as a designer) and later participates in the award procedure as the tenderer. The objection that the tenderer had a longer preparation period is refuted by the fact that all tenderers must have the same deadline for submitting tenders, determined at such a length as to ensure that everyone has an equal opportunity to bid.

4.2. Non-discrimination

The principle of non-discrimination is similar to the above-mentioned principle of equal treatment. The difference between the principles may not always be clearly distinguished in practice because the boundary between the two principles is relatively unclear. Even the use of the terms "equal treatment" and "non-discrimination" can be considered almost synonymous. The Act accordingly to the directives sets out both principles separately. The difference may be seen in the fact that each of the principles is relevant at a different stage of the procurement process. Also, the principle of equality can in certain circumstances require taking affirmative action in order to diminish or eliminate conditions that cause or help to perpetuate discrimination. Discrimination generally can mean "different, other approach to one group than to another or everyone else. The concept of discrimination in the field of public procurement, means making participation in the award procedure harder or the complete exclusion of possible participation in the award procedure for one or more specifically or generally designated contractors. The Supreme Administrative Court, for example, in its judgment Ref. No. 1 Afs 20/2008, of 5 June 2008, held that: "The concept of discrimination primarily implies ... different treatment of the individual compared to the other members of the group being compared." No tenderer may be favoured over others unless it is envisaged by the Act. A legal advantage is allowed for, where economic operators employing persons with disabilities are favoured. A typical example of a violation of this principle is the unauthorized use of a negotiated procedure without disclosure, which discriminates against all contractors who have not been invited. Another case is selection of unfair criteria of participation, e.g. requirements related to minimum capacities which are not objectively necessary to be met for the award procedure at issue.

4.3. Transparency

EU public procurement legislation stresses the principle of transparency. This principle includes the principle of accountability in the public sector, in particular requirements for the transparency of procurement by contracting authorities. The purpose of this principle is to ensure the possibility of reviewing all the acting of the contracting authority and thus for the possibility of its full control. The principle aims to motivate the contracting authority to prevent any form of corruption, and to refrain from any activities that could be viewed as incentives to suppliers to enter into unlawful agreements. Observance of the principle of transparency thus ensures that the tenderers, contracting authorities and the public are informed as much as possible about the progress of public procurement. First of all, the principle of transparency requires that as many suppliers as possible are able to learn about the public contract and can take part in the award procedure. Further, it should stimulate the procedure to be foreseeable and in accordance with the principle of legal certainty. Finally, all the acts that the contracting authority makes should be reasoned and the reasons made known to all whom it may concern. The same applies to the final decisions of any public authority or court that reviews acts of the contracting authority. According to the judgment of

the Supreme Administrative Court of 15 September 2010, Ref. No. 1 Afs 45/2010 - 159, the principle of transparency is violated if "there are elements found in the practice of the contracting authority that would make the award procedure unmanageable, less controllable, unreadable and unclear, or raise doubts about the true reasons of the contracting authority's actions." Thus, a procedure is transparent when it raises no doubts as to whether the acting of the contracting authority is correct. The same approach is also apparent from the Regional Court in Brno judgment dated 19 January 2012, Ref. No. 62 Af 36/2010 – 103. The court has ruled that the purpose of the transparency principle is to "ensure that public procurement is conducted in a transparent, legally correct and predictable manner, with conditions set in advance and in a clear and comprehensible manner."

A common example, when the principle of transparency is breached, is when a contracting authority provides additional information to only some tenderers. It may not be provided solely to those who have requested it, or only to some of the tenderers who have picked the tender dossier because the contracting authority simply did not register all the potential tenderers and has no list available. Such acting is unreviewable and thus non-transparent. It would also provide an advantage only to some tenderers, and therefore constitute breach of another principle of equal treatment vis-à-vis tenderers. Furthermore, the course of the awarding procedure should be transparent, acts of the contracting authority understandable and duly reasoned, and all acts carried out in writing. This enables review of the contracting authority's acts by public authorities (competition offices). The principle must be observed even after the award procedure is terminated. For example, in the judgment of the Regional Court in Ústí nad Labem of 25th April 2012, ref. No. 15 Ca 89/2009, the court concluded that ... "the principle of transparency must be observed not only at all stages of procurement procedure but also after termination thereof in cases where tenderers within the limits of the Act on Free Acess to Information request the contracting authority to provide certain information on the procurement procedure carried out. The purpose of the transparency principle is undoubtedly that a particular award procedure could be regarded legible and, in a sense, predictable and subject to effective public control." To summarise, award procedure is transparent when following essential data are known: (i) who made the decision, (ii) what was decided, (iii) how, and (iv) why. These data should be stored in the procurement documents in order to allow subsequent control.

4.4. Proportionality

The principle of proportionality is a reaction to the fact that the law leaves the contracting authorities with a large margin of discretion as to the choice of a particular course of action during the procurement procedure. Thus, acting in accordance with the principle of proportionality, means primarily that, the contracting authority will carry out such a procurement procedure that will not unduly restrict competition beyond the scope of the above-mentioned objective. At the same time the contracting authority is provided with sufficient assurances that the procedure will lead to the choice of supplier who will actually be able to carry out the public contract well and within the deadlines set. According to the principle of proportionality, the contracting authority must therefore set the parameters of the procurement procedure in such a way as to be proportionate to the nature and subject of the public contract.

Contracting authorities should follow the principle in all phases of the award procedure. One of the areas where this principle is applied is when contracting authority is setting up parameters of the procurement procedure. These must adequately correspond to the subject and the value of the performance, for example in the case of proving the capacities of the individual suppliers and in a reasonable setting of the number and value of the reference orders. The contracting entity may not require an excessive number of reference orders with

multiple times the volume of performance than the award of the public contract. By analogy, the principle of proportionality applies when defining the time-limits in the procurement procedure. In the case of a time limit for submitting a bid, it is appropriate to consider a time limit which is sufficient from the point of view of the tenderer as a professionally qualified professional to prepare the tender, in particular the drafting of the contract, the responsible valuation of the public contract's subject-matter and the thorough preparation of other documents required by the contracting authority. Court of Justice of the EU found in one of the latest cases, C-27/15, dated 2 June 2016, dealing with proportionality and capacities that a situation whereby national legislation may allow economic operators to rely on the capacities of one or more third-party entities for the purpose of satisfying minimum requirements for participating in a tendering procedure which are only partially satisfied by that operator. However, it seems that proportionality is not endowed with the same importance as the other principles. In case C 171/15 of 14 December 2016 the Court of Justice of the EU held that the provisions of directives … read in the light of the principle of equal treatment and the obligation of transparency which derives from that, must be interpreted as precluding a contracting authority from deciding to award a public contract to a tenderer which has been guilty of grave professional misconduct on the ground that the exclusion of that tenderer from the award procedure would be contrary to the principle of proportionality, even though, according to the tender conditions of that contract, a tenderer which has been guilty of grave professional misconduct must necessarily be excluded, without consideration of the proportionality of that sanction. The Act is the first piece of Czech legislation covering public procurement that expressly contains the principle of proportionality. The explicit enactment of this principle into law has its origins in the text of the public procurement directives, in particular Article 18 (2) of Public Sector Directive. This principle could have been inferred from the previous legislation - under both EU law and Public Procurement Act No. 137/2006 Coll., even though it was not explicitly stated. However, its explicit inclusion in the Act reinforces the legal certainty of the entities involved in the public procurement process. The principle was practically unreservedly accepted in the domestic decision-making practice and in the case-law of the administrative courts. Most often in the context of the interpretation of the concept of hidden discrimination, where the "obvious disparity" of qualification prerequisites in relation to the subject of a particular public contract was considered a key issue of hidden discrimination. One of the first decisions, where the hidden discrimination was classified by the court as a question of proportionality, was the Supreme Administrative Court's Judgment Ref. No. 1 Afs 20/2008-152 of 5 June 2008. The Court based its decision on detailed reasoning including a comparative and euroconform interpretation, and concluded that "…a hidden form of unacceptable discrimination in procurement procedures can be also seen in the procedure by which the contracting authority prevents certain suppliers from applying for a public contract by setting such qualification prerequisites where the required level of technical competence is clearly disproportionate in relation to size, complexity and technical demands of a particular public contract. It was evident, that in the case the Court was dealing with, only some of the economic operators who otherwise would objectively be able to fulfil the subject-matter of the public contract, were allowed to participate in the procurement procedure precisely for these disproportionate qualifying assumptions." Further, the Regional Court in Brno, in its judgment of 10th March 2011, ref. No. 62 Ca 15/2009-71 stated that: "Conclusion on the proportionality and therefore the legality of the economic and financial qualification requirements and the technical qualification requirements may not be result of arbitrary considerations abstracted from the market in which the tender for the award of a public contract is to take place, or from the specific consequences that such qualification requirements may have on market conditions, in view of the participation of suppliers in the

tender for the award of a public contract. " Thus, as the case law is rather fragmented, the specific scope of the principle of proportionality is left to decision-making.

4.5. Other principles seeking to ensure efficient and effective spending

From the national perspective, the primary purpose of public procurement is to ensure that public funds are spent efficiently and effectively. Therefore, other principles stem from this very purpose of public procurement to award the contract to an economic operator who will provide best value for public money spent. They intend to secure the effective handling of public funds which the contracting entity is handling, either solely or partially. The awarding procedure should lead to the acceptance of the most advantageous bid which meets the specified requirements of the contract's subject-matter. The most advantageous offer is either the lowest bid or the most economically advantageous offer. The EU law does not require national legal measures to adhere to these principles, as explained already above. Thus national legislation may differ, however it still needs to comply with the principles securing that competition is not distorted.

These principles may turn out to be contradictory. In the studied case of the Czech Republic, compliance with these principles is ensured by individual provisions of the Act. Although, the principles are not expressly covered by the already mentioned Sec. 6, they may be drawn from other acts applicable to the public sector. The Regional Court in Brno dealt with this issue in its judgment of 26th April 2012, file No. 62/2010 61/2010 - 332, where it concludes that "…the contracting authority is obliged to proceed not only in accordance with the principles enshrined in Sec. 6 of the Act (i.e. principles of transparency, equal treatment and non-discrimination), but also according to the principle of cost-effectiveness of the management of public funds and the principles of ensuring competition and the competitive environment."

5. CONSLUSION

On the EU level, the principles applicable to public procurement stem from TFEU, and they are also expressly mentioned in the public procurement directives. Their aim is to provide for the widest possible preservation of competition. They thus seek to prevent hidden discrimination, i.e. seek to ensure that opportunities are opened up to economic operators from all Member States, by requiring contracts to be advertised and awarded through a competition and, secondly to ensure a minimum level of transparency so that Member States may not easily conceal discriminatory award decisions. Out of the four main principles - principle of equal treatment, non-discrimination, transparency and proportionality – the Court of Justice of the EU stresses in its case law the principles of equal treatment and transparency. However, they are interpreted rather broadly, which leaves states and contracting authorities with legal uncertainty. Furthermore, the case law is casuistic.

Still, the analysis has proven that the Czech administrative courts are fully aware of the European case law and their interpretation of the four essential principles is euroconform. This may be demonstrated on the principle of proportionality, which has been applied by the Czech courts already before it has appeared in the Act. Also, EU law allows for further principles to be enacted by Member States in their national public procurement measures. Most important are those, the goal of which is to ensure that public funds are spent efficiently and effectively. Even though the Act No. 134/2016 Coll., On Public Procurement, does not contain express statement of such principals (as did not the act preceding it), the Czech administrative courts derive those from other legal measures applicable to management of public funds.In practice, however, they are often neglected because the contracting authorities are not sure to link these principles to public procurement and thus they do not realize that such negligence is contradictory to obligations relating to public procurement.

LITERATURE:

1. Act on Public Procurement (2016). Act No. 134/2016 Coll., On Public Procurement. Retrieved 12 May 2017 from http://aplikace.mvcr.cz/sbirka-zakonu/SearchResult.aspx?q=134/2016%20&typeLaw=zakon&what=Cislo_zakona_smlouvy.
2. Arrowsmith, S. The Past and Future of EC Procurement Law: From Framework to Common Code? (2006) *Public Contract Law Journal*. Vol. 35, No. 3. Spring 2006.
3. Bagarová Grzywa, M. (2003) Modern municipality: Public Procurement and Transparency (in Czech: Moderní obec: Veřejné zakázky a jejich transparentnost) Retrieved 13.03.2017 from http://moderniobec.cz/verejne-zakazky-a-jejich-transparentnost/
4. Balýová, L. (2015) Public procurement. (in Czech:Veřejné zakázky.) 1. edition. Praha: C. H. Beck, 2015. ISBN 978-80-7400-560-2.
5. de Mars, S. (2013). The Limits of General Principles: A Procurement Case Study. In European Law Review, Vol. 38, No. 3, p. 316, 2013. Retrieved 13.05.2017 from SSRN: https://ssrn.com/abstract=2294010 or http://dx.doi.org/10.2139/ssrn.2294010
6. Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014, on the award of concession contracts.
7. Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014, on public procurement and repealing Directive 2004/18/EC.
8. Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014, on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC.
9. Havelková, M. (2017). Public procurement – principles of the procurement procedure. (Master thesis). (In Czech: Veřejné zakázky – zásady zadávacího řízení). University of Pardubice, Faculty of Economics and Administration.
10. Herman, P. (2016) Commentary on the Public Procurement Act. (In Czech: Komentář k zákonu o zadávání veřejných zakázek.) Plzeň: Vydavatelství a nakladatelství Aleš Čeněk. ISBN 978-80-7380-595-1.
11. Judgment of the European Court of Justice of 25 July 1991, C-221/89
12. Judgment of the European Court of Justice of 25 April 1996, C-87/94
13. Judgment of the Court of Justice of the EU of 3 December 2001, C-59/00
14. Judgment of the Court of Justice of the EU of 19 June 2008, C-454/06
15. Judgment of the Court of Justice of the EU of 1 April 2010, C-96/08
16. Judgment of the Court of Justice of the EU of 21 February 2013, C-111/12
17. Judgment of the Court of Justice of the EU of 2 June 2016, C-27/15
18. Judgment of the Court of Justice of the EU of 7 September 2016, C-549/14
19. Judgment of the Court of Justice of the EU of 14 December 2016, C 171/15
20. Judgment of the Supreme Administrative Court of the Czech Republic of 12 May 2008, Ref. No. 5 Afs 131/2007 – 132
21. Judgment of the Supreme Administrative Court of the Czech Republic of 5 June 2008, Ref. No. 1 Afs 20/2008-152
22. Judgment of the Supreme Administrative Court of the Czech Republic of 15 September 2010, Ref. No. 1 Afs 45/2010 - 159.
23. Judgment of the Regional Court in Brno of 7 April 2009, Ref. No. 62 Ca 28/2008-74
24. Judgment of the Regional Court in Brno of 1 July 2010, Ref. No. 62 Ca 9/2009
25. Judgment of the Regional Court in Brno of 16 March. 2011, Ref. No. 62 Ca 29/2009

26. Judgment of the Regional Court in Brno of 19 January 2012, Ref. No. 62 Af 36/2010 – 103.
27. Judgment of the Regional Court in Brno of 26 April 2012, Ref. No. 62 Af 61/2010 – 332
28. Judgment of the Regional Court in Brno of 19 July 2012, Ref. No. 62 Af 1/2011
29. Judgment of the Regional Court in Ústí nad Labem of 25 April 2012, Ref. No. 15 Ca 89/2009.
30. Jurčík, R. (2014) Public procurement and Concessions. (in Czech: Veřejné zakázky a koncese.) 2. edition. Prague: C.H. Beck. ISBN 978-80-7400-443-8.
31. Košťál, K. a Marečková, E. (2014) Equal Treatment or Discrimination? (in Czech: Rovné zacházení či diskriminace?) *Epravo.cz* [online]. Retrieved 13.03.2017 from nbvhttps://www.epravo.cz/top/clanky/ rovne-zachazeni-ci-diskriminace-95774.html
32. Kouřilová, K. (2017) The principle of proportionality in the procedure of the contracting authority in the procurement procedure. (in Czech: K zásadě přiměřenosti při postupu zadavatele v zadávacím řízení.) *Epravo.cz* [online]. Retrieved 04.04.2017 from: https://www.epravo.cz/top/clanky/k-zasade-primerenosti-pri-postupu-zadavatele-v-zadavacim-rizeni-105563.html
33. Kruták, T. a Krutáková, L. (2013) Public Procurement Law with Commentary and Examples. (in Czech: Zákon o veřejných zakázkách s komentářem a příklady.) 2. edition, Olomouc: Anag, 2013. ISBN 978-80-7263-778-2.
34. Ochrana, F., Hrnčířová K. (2015). Does the Lowest Bid Price Evaluation Criterion Make for More Efficient Public procurement Selection Criterion? (Case of the Czech Republic). NISPAcee Journal of Public Administration and Policy, Vol. VIII., No. 1, pp. 41-59. Retrieved 12th May 2017, from doi:10.1515/nispa-2015-0003
35. Plaček, M., Ochrana, F., Schmidt, M., et al. (2016). The Evaluation of the Role of the Office for Protection of Competition of the Czech Republic in Regulating Public Procurement. NISPAcee Journal of Public Administration and Policy, Vol. IX., No. 1, pp. 97-116. Retrieved 12th May. 2017, from doi:10.1515/nispa-2016-0005
36. Podešva, V. (2016) Public Procurement Act: Contract Register Act: Commentary (in Czech: Zákon o zadávání veřejných zakázek: Zákon o registru smluv: komentář.) First edition. Prague: Wolters Kluwer. Komentáře. ISBN 978-80-7552-102-6.

EU PERSONAL DATA PROTECTION RULES FOR DIGITAL AGE

Ivana Markovinovic Zunko
Law Firm Vedriš & Partners Ltd, Croatia
ivana.markovinovic@vedris-partners.hr

ABSTRACT

The protection of personal data has been derived from the general right to privacy and it has been recognized in the European convention on Human Rights as one of the fundamental rights. The importance of this principle has been confirmed by adoption of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data which has established strict rules in order to ensure high standards of protection everywhere in the EU. Recently the established rules and practice have been challenged due to the evolution of the privacy issues caused by new technologies and the reform of the data protection rules has been recognized as the condition for the implementation of the Digital Single Market Strategy, major project of the EU that should enable free movement of goods and services in the digital environment. The result is adoption of 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) and accompanying new directive. The major aim of the new rules is to strengthen citizen's control over of their personal data, and to simplify the regulatory environment for business. The aim of this paper is to provide the insight into the new rules and to discuss the challenges of their implementation in the EU countries.

Keywords: *data protection, digital environment, free movement, transfer, privacy*

1. INTRODUCTION

Everyone has the right to the protection of personal data – this principle has been derived from the general right to privacy, which is one of the fundamental human rights according to the European convention on Human Rights. In 1980 fundamental principles for protection of personal data have been recognized by the European authorities, which led to adoption of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data. The mentioned directive, known as Data Protection Directive has established strict rules in order to ensure high standards of protection everywhere in and outside the European Union.

In January 2012, the European Commission proposed a comprehensive reform of data protection rules in the EU which led to adoption of 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) 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. On 4 May 2016, the official texts of the Regulation and the Directive have been published in the EU Official Journal. The General Data Protection Regulation (GDPR) entered into force on May 24, 2016 and it shall apply from May 25, 2018.

The Directive entered into force on May 5, 2016 and EU Member States must transpose it into their national law by May 6, 2018. The data protection reform should be key enabler of the Digital Single Market that should allow European citizens and businesses to fully benefit from the digital economy. The objective of this paper is to assess whether is to be expected that those goals will be accomplished and whether the new rules can give citizens back control over of their personal data and simplify the regulatory environment for business as proclaimed. For this purpose first the general overview of the historical background and present status of data protection is provided followed by the summary of the main changes in the GDPR.

2. HISTORICAL BACKGROUND OF THE DATA PROTECTION IN THE EU

2.1. Privacy as the fundamental human right in the ECHR

The right to protection of personal data is one of the rights explicitly protected under the European convention on human rights (ECHR). The ECHR was drafted by the Council of Europe in Rome on 4 November 1950 as first written implementation of principle of the United Nation's Universal Declaration of Human Rights as the fundamental modern act on civil liberties. ECHR entered into force three years later with the aim to contribute to promotion and protection of the most important human rights, one of them being the right to privacy. It has been stipulated by the Article 8 of the ECHR that everyone has the right to respect for his private and family life, his home and his correspondence. Furthermore, it has been emphasised that there shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others. All the European states members of Council of Europe States were obliged to comply with the ECHR and to incorporate in their national law. To ensure that they observe their obligations set under the ECHR, the European Court of Human Rights, was set up in Strasbourg, in 1959. Throughout its practice the court shall examine many cases where the issue of data protection was challenged and clarify that the Article 8 not only obliges the states to refrain from any actions violating the right to privacy but also to actively protect it.

For some of the European countries the protection of privacy was not the new achievement. For example, in France, where the privacy has always been appreciated due to the cultural sensibility, the right to private life was guaranteed by the Napoleonic Code back in 19th century. France was one of the first countries in Europe to enact a privacy law – in 1978 the French parliament passed the Act No 78-17 on Information Technology, Information Technology, Data Files and Civil Liberties dated 6 January Data Files and Civil Liberties. The Act stipulates that any person company or government agency receiving or processing personal information without authorization could be punishable by up to six months in prison and a maximum fine of 20,000 francs. Passing of the Act was apparently reaction to the affair known as Project Safari from 1974. The central point of the project was the draft of the security law that supposed to enable the government to use social security numbers to interconnect all personal administrative data but due to the extremely negative reaction of the French people that felt hunted through their data, the authorities were forced to restrain from implementation of the act.

2.2. Convention 108

With the rise of information society and arrival of Information, Communication Technology in the 1970s that was followed by the development of the automated files, the European states gradually become more and more concerned about protection of privacy which. The result

was the adoption of the "Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data," signed by the Council of Europe in Strasbourg in 1981. The Convention, known as the Convention 108 is supposed to ensure that all processing of personal data was consistent with Article 8 of the ECHR and it is considered to be the base of the modern EU privacy policy. As stated in the Preamble, taking account of the increasing flow across frontiers of personal data undergoing automatic processing, it was desirable to extend the safeguards for everyone's rights and fundamental freedoms, and in particular the right to the respect for privacy, reaffirming at the same time their commitment to freedom of information regardless of frontiers and recognising that it is necessary to reconcile the fundamental values of the respect for privacy and the free flow of information between peoples.

Convention 108 contains the principles for processing of personal data that should strengthen their protection. Those principles should be transposed by the states into their domestic legislation in order to ensure that data are processed lawfully and for a specific purpose only. Furthermore, the data should not be stored longer than is necessary and the request for proportionality should be met. The Convention also provides measures of control available to individuals, such as the right to obtain confirmation of whether personal data are stored and the right to obtain rectification of such data. Besides principles in relation to the collection and processing of personal data, the Convention also provides the rules for the processing of "sensitive" data on a person's race, politics, health, religion, sexual life, criminal record, etc., in the absence of proper legal safeguards. Restriction on the rights laid down in the Convention are only possible when overriding interests are threatened. The Convention also imposes some restrictions on transborder flows of personal data to States where legal regulation does not provide equivalent protection. The Additional Protocol to the Convention 108 that came to force in 2004 provides that each party shall provide for one or more authorities responsible for ensuring compliance with the measures in its domestic law giving effect to the stated principles. The Protocol also provides the improvement in relation to data flows to third countries by imposing that the personal data may only be transferred if the recipient State or international organisation is able to afford an adequate level of protection. The efforts to modernise the Convention 108 continued with the aim to respond to challenges for privacy resulting from the use of new information and communication technologies in the digital age and to strength the Convention’s follow-up mechanism. The Convention 108 is the first binding international instrument on data protection. As it is open for accession to non-member states of the Council of Europe, it has the potential to serve as a universal standard at global level. It was opened for signature on 28 January 1981 in Strasbourg. The first non-European country to ratify the Convention 108 was Uruguay in 2013. So far it is in force in most of the European countries, as well as in in Senegal in Mauritius. It should be mentioned that in the United States of America recently there were certain initiatives to urge the authorities to support the Convention 108. The global dimension of Convention 108 is often pointed out as very important both for the individuals to which the Convention applies without discrimination on the basis of nationality or residence and for companies that are involved in cross-border business, namely that work in international environment where the unify data protection rules are highly appreciated.

2.3. Data Protection Directive

Increasing awareness of data protection importance led to a more binding form of governance, namely adopting of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data. The mentioned directive, known as Data Protection Directive is adopted by the European Union with the aim to protect the

privacy and ensure the protection of all personal data by giving the substances to already established principles, particularly those established by the Convention 108, and to expand them. The Directive took effect three years after it was formally approved, in October, 1998. Its purpose is dual: firstly, the Directive seeks to guarantee adequate protection of a fundamental right by establishing
minimum standards for the use of personal data and secondly it seeks to harmonize the data protection laws of Member States. It was adopted at a time when several Member States had already adopted national data protection laws so the harmonization of those rules was necessary in order to enable the smooth functioning of the internal market. It was explicitly stipulated that if a Member State already had a higher or more extended standard of protection before the entering into force of the directive, this standard could be maintained. The Court of Justice of the European Union (CJEU) in Luxembourg has jurisdiction to determine whether a Member State has fulfilled its obligations under the Data Protection Directive and to give preliminary rulings concerning the validity and interpretation of the directive, in order to ensure its effective and uniform application in the Member States. An important exemption from the applicability of the Data Protection Directive is the so-called household exemption, namely the processing of personal data by private individuals for merely personal or household purposes.
The material scope of the directive is limited to matters of the internal market. Outside its scope of application are matters of police and criminal justice cooperation. Additionally, even in areas covered by the Data Protection Directive, more detailed data protection provisions are often needed in order to achieve the necessary clarity.
According to the Article 2a of the Directive, personal data means "any information relating to an identified or identifiable natural person ('data subject'); an identifiable person is one who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity". Data is considered personal when it enables anyone to link information to a specific person, even if the person or entity holding that data cannot make that link. Examples of such data include address, bank statements, credit card numbers, and so forth. Processing is also broadly defined and involves any manual or automatic operation on personal data, including its collection, recording, organization, storage, modification, retrieval, use, transmission, dissemination or publication, and even blocking, erasure or destruction.
These data protection rules apply not only when responsible subjects – so-called controllers are established or operate within the EU, but whenever the controller uses equipment located inside the EU to process personal data meaning that controllers from outside the EU who process personal data inside the EU must nevertheless comply with the Directive.
According to the Directive, EU Member States are obliged to set up national supervisory authorities whose task is to monitor data protection levels in that state, and to advise the government about related rules and regulations, and to initiate legal proceedings when data protection regulations are broken. All controllers must notify their governing authority before commencing any processing of personal information, and such notification prescribes in detail what kinds of notice is expected, including name and address of the controller or representative, purpose(s) of the processing, descriptions of the categories of data subjects and the data or categories of data to be collected, recipients to whom such data might be disclosed, any proposed transfers of data to third countries, and general description of protective measures taken to ensure safety and security of processing and related data.
According to the EU regulation, the Member States shall neither restrict nor prohibit the free flow of personal data between Member States for reasons connected with the protection, meaning the question on adequacy of the protection should be only applied in case of transfer to the “third countries”. Based on the Directive, The Council and the European Parliament

have given the Commission the power to determine whether a third country ensures an adequate level of protection - the Commission has so far recognized Andorra, Argentina, Canada (commercial organisations), Faeroe Islands, Guernsey, Israel, Isle of Man, Jersey, New Zealand, Switzerland and Uruguay as providing adequate protection, namely to those "third countries" the personal data can be transferred from EU countries and three EEA member countries (Norway, Liechtenstein and Iceland) without any restrictions.

The status of the United States of America, as clearly the most important destination in the practice has been radically challenged due to the collapse of so-called Safe Harbor rules. The Safe Harbour Privacy Principles were originally designed between 1998-2000 in order to prevent private organizations within the European Union or United States which store personal data of clients from their accidental disclosure or lost. The US companies that adhered to the basic principles for data protection could opt into a program and be certified as providing adequate level of protection in terms of EU requirements. In 2000, the European Commission decided that to such US companies the data can be safely transferred from the EU - this is referred to as the Safe Harbour Decision. On 6 October 2015, the European Court of Justice invalidated the Safe Harbour Decisions in the famous case against Facebook initiated by an Austrian privacy activist Max Schrems who argued that Safe Harbour agreement that allows thousands of US companies, including Google, Facebook, and Apple to repatriate European personal data in practice does not offer any data protection.

However, after intensive discussions, the new arrangement known as EU-US Privacy Shield was agreed on 2 February 2016 that should provide stronger obligations on companies in the USA to protect the personal data of Europeans and also stronger monitoring and enforcement. Despite of the certain negative aspect such as failure to ensure effective protection from export of the data to USA or the lack of harmonization, the general impression is that the impact of the Directive is positive, particularly in confirming of the main data protection principles.

3 KEY TERMS AND PRINCIPLES OF THE EU DATA PROTECTION

3.1. OECD Recommendation

In 1980, in an effort to create a comprehensive data protection system throughout Europe, the Organization for Economic Cooperation and Development (OECD) issued its "Recommendations of the Council Concerning Guidelines Governing the Protection of Privacy and Trans-Border Flows of Personal Data". The seven principles governing the OECD's recommendations for protection of personal data were:

Notice—data subjects should be given notice when their data is being collected;

Purpose—data should only be used for the purpose stated and not for any other purposes;

Consent—data should not be disclosed without the data subject's consent;

Security—collected data should be kept secure from any potential abuses;

Disclosure—data subjects should be informed as to who is collecting their data;

Access—data subjects should be allowed to access their data and make corrections to any inaccurate data; and

Accountability—data subjects should have a method available to them to hold data collectors accountable for not following the above principles.

3.2. EU data protection principles

The governing rule is that personal data should not be processed at all, except when certain conditions are met. These conditions imposed by the Data Protection Directive can be summarized as: transparency, legitimate purpose, and proportionality.

Transparency requires that data subject has the right to be informed when his personal data is being processed. The controller must provide his name and address, the purpose of

processing, the recipients of the data and all other information required to ensure the processing is fair. Data may be processed only in certain cases, namely when the data subject has given his consent; when the processing is necessary for the performance of or the entering into a contract; when processing is necessary for compliance with a legal obligation; when processing is necessary in order to protect the vital interests of the data subject; processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the controller or in a third party to whom the data are disclosed or if processing is necessary for the purposes of the legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed. Legitimate purpose principle requires that the personal data can only be processed for specified explicit and legitimate purposes and may not be processed further in a way incompatible with those purposes. Proportionality principle imposes the rule that personal data may be processed only insofar as it is adequate, relevant and not excessive in relation to the purposes for which they are collected and/or further processed. The data must be accurate and, where necessary, kept up to date; every reasonable step must be taken to ensure that data which are inaccurate or incomplete, having regard to the purposes for which they were collected or for which they are further processed, are erased or rectified. The data shouldn't be kept in a form which permits identification of data subjects for longer than is necessary for the purposes for which the data were collected or for which they are further processed.

4. NEW EU LEGISLATION ON DATA PROTECTION

4.1. General context - Digital Single Market

Only decade after the Directive came into force, it was obvious that the data protection in the new reality of the Internet will be challenged and that the Directive would not suffice. Some of the main challenges arise from the nature of the digital world – how to protect privacy when personal data is everywhere online, how to ensure personal control, who is responsible in case of misusage?

Ever since of the founding treaties, Single Market has been recognized as top priority for functioning of the European Union. As astonishing development of the digital technologies has completely transformed both the business and life in general, the time came to make the EU's single market fit for the digital age. In May 2015 the European Commission adopted a communication proposal “A Digital Single Market Strategy for Europe” that introduced various initiatives with the aim to break down the barriers in using of on-line tools and services so that citizens and business can freely access them regardless of their nationality and place of residence. It has been recognized that despite of the nature of the on-line transactions that know no borders or any territorial restriction, European markets are largely domestic in terms of on-line services which prevents their development and growth. The Strategy should help to harmonize functioning of the single market as the EU basic principle in the contemporary environment strongly influenced by the development of the digital technologies and their impact on business and every-day life. It is based on three pillars: Access to digital goods and services; Environment of conditions where digital networks and services can prosper and Economy & Society in which the potentials of the new market can be fully developed. The third pillar is concerned with promotion of the free movement of data as sometimes the present restrictions do not have anything to do with protection of personal data and the data economy built on Big Data, cloud services and Internet of Things is central for the EU’s competitiveness on the global market.

4.2. Overview of the new law

It was clear that the data protection law should be changed to fit into the Internet era, but the task was not easy at all. The studies conducted in preparations of the new legislation showed

that the expectations differ depending on the stakeholders: for the individuals the law should enable to retain safeguards whenever personal and to exercise control over their personal data; from the aspect of the organisations, the use of personal data should be subject to clear rules that would ensure legitimacy of their activities.

After four years of intensive work the new EU data protection legislative framework was adopted in April 2016. and ever since it is subject of great discussion in the business, political and academic circles. First impression after brief review of its 99 Articles and is that the GDPR is complex and demanding in the extent that some manual would be very helpful. In this respect it should be mentioned that the Article 29 Working party – group of professionals coming from the EU national data protection authorities has been working on guidelines on the GDPR provisions that should help organisations to prepare for the new regulation implementation in 2018.

Clearly, the changes are deep and cannot be summarised but some of the main features can be detected. Firstly, the new rules are in the form of regulation, which guarantee higher level of harmonization as the regulation applies directly in all Member states. This is certainly positive change from the aspect of the organisations that operate in various countries and who had to comply with inconsistent data protection rules in the EU.

Territorial scope of rules has been significantly expanded – if the controllers and processors outside the EU process the activities related to the offering of goods or services or monitoring the behaviour of EU data subjects within the EU, they are subject to the GDPR, which was not the case before.

In terms of the subject involved, the GDPR applies to 'controllers' and 'processors'. Although the definitions mainly remained unchanged the role of the processor has been significantly changed which is considered as one of the crucial changes of the new rules. GDPR imposes specific legal obligations for officers including the obligation to maintain a written record of processing activities carried out on behalf of each controller and immediate notification of the controller on becoming aware of a personal data breach. Moreover, a supervisory authority can address directly to processors with requests and demands what should contribute to better balance of power between controllers and processors. GDPR also imposes some further obligations to the controller aiming to ensure that the contracts with the processors comply with the rules. The controllers in general have very strict requirements to comply with: they need to maintain documentation, conduct assessment for processing of higher risk and implement data protection by design and by default. This means that it will be mandatory when designing a new system that processes personal data to make sure that data protection considerations are taken into account starting from the early stages of the design process and also when such system includes choices for the individual on how much personal data is to be shared with others, the default setting should be the most privacy friendly one, which leads to data minimisation. In certain cases, data controllers and processors must designate a Data Protection Officer as part of their accountability programme. Accountability in general is the new principle of data protection introduced by the GDPR that requires from organisations not only to be responsible for adhering to all the rules, they also must be able to demonstrate compliance.

The GDPR explicitly recognise binding corporate rules for controllers and processors that must expressly confer enforceable rights on data subject. In terms of material scope, the GDPR applies to 'personal data' as the Directive but the GDPR's definition is more detailed and expanded. For instance, information such as an online identifier (IP address) is now considered as personal data. Moreover, the pseudonymised personal data can also fall within the scope of the GDPR. The GDPR maintain the concept of the sensitive personal data as "special categories of personal data" with minor changes such as inclusion of the biometric data. One of the main goals of the reform stressed out during the preparation of the new

legislation was strengthen of the rights of individuals which resulted with the new right that has been granted to individuals: the right to data portability, which basically means the right to transport his personal data from one organisation to the next. It also includes that individuals can ask to receive their personal data in a structured and commonly used format so that it can be easily transferred.

Another data subject right related to the strengthening of the position of the individual is the right to be forgotten. It had already existed, but it has been named as the "right of erasure" and it allows the individuals to require from the data controllers, under the new more favourable terms, to erase their personal data. The list of conditions that should be met in order to exercise this right includes the case when a data subject withdraws previously given consent. Concerning the requirements for consent, it must be freely given. The assessment whether the consent is freely given is particularly important in case where the positions of data subject and data controller are not balanced. In general, the consent is not freely given if data subject had no genuine and free choice or is unable to withdraw or refuse consent without detriment. Furthermore, the consent must be specific, informed and unambiguous. In case of sensitive data, it must be given in explicit form.

From organisational point of view, there are some significant changes. Firstly, the obligation to notify local authorities on processing of the personal data is no longer in place. Instead of such general notification, organisation now must maintain a record of processing activities, namely the inventory of the data processed. Data controllers also need to apply effective procedure and procedures focusing particularly on more risky operation. In this respect, the GDPR introduces Data Protection Impact Assessments (DPIA) as a mean to identify high risks to the privacy rights of individuals when processing their personal data. When these are identified, the GDPR expects that an organisation formulates measures to address these risks. This assessment should happen prior to the start of processing the personal data and should focus on topics like the systematic description of the processing activity and the necessity and proportionality of the operations.

One of the most controversial aspect of the GDPR is the imposing of fines, namely penalties for breach which enables local data protection authorities to impose increased fines that for more serious violations go up to € 20 million or 4 % of annual worldwide turnover.

The important part of the reform is also introducing of the 'one stop shop' system for supervisory authorities that will operate parallel with the local authorities on the cooperation base. Such 'Lead Supervisory Authority' will be the supervisory authority of the country of the data processor or data controller, but the whole system is quite complex as it requires practical distinction between cross-border and domestic processing. However, enhanced powers of independent authorities and cooperation between those authorities together with the new concept of accountability are considered to be the most significant improvement provided by GDPR.

5. CONCLUSION

Europe has a long history of data protection which has been strongly confirmed by establishment of the right on privacy as one of the fundamental human rights by the Article 8 of the ECHR in 1959. Data protection started to develop more intensively with the development of the new technologies and the need to have clear rules on data processing become apparent. Therefore the Council of Europe adopted Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data in 1980. The Convention, known as Convention 108 is still considered to be one of the most important tools in data protection that set basic terms and conditions for processing of data worldwide. However, as the international treaty, the Convention become insufficient in the context of the European Union which required more unified rules on its territory. The result was launching of the Data

Protection Directive in 1995 as a more binding form of governance. The Directive has provided new definitions of all the key terms and imposed rather strict rules on all forms of data processing. However, transposing of the rules set by the Directive in the national legislations has not resulted with the unified rules as expected, but with inconsistent interpretation and the implementation of the Directive. Moreover, further development of the technology and Internet in particular, brought new challenges and it soon became obvious that the new reform is required. The work on the changes officially started in 2012 and they corresponded with the idea on necessity of deeper change of the EU legal environment in order to make Europe fir for the digital age, namely establishment of so-called Digital Single Market. The adoption of the GDPR is the result of those efforts – whether the goals proclaimed will be achieved is too early to assess as the GDPR has not been in application yet. The legal nature of the legislation is changed to the regulation meaning that the application of the rules will be direct which should finally lead to the harmonization of all the national legislations. Whole concept of the data processing is now balanced between data controllers and data processors and some new players as the officers and Lead Supervisory Authorities have been introduced. However, the main principles of data protection established almost 50 years ago remained mostly unchanged or in some aspect – strengthen. The best example is position of the individual that now should gain more control over his personal data.

As already said, it is too early to provide an opinion whether the new rules provide the adequate answer to modern data protection challenges. However, it is obvious that from purely technical point of view the GDPR can hardly be seen as the act containing the comprehensive and simplified rules. From substantive point of view, it seems that despite of the introduction of the concepts and new subjects, the GDPR still does not offer the adequate mechanism for protection of the personal data that are literally everywhere in increasingly digital reality. Any idea of controlling of the processing of such data still seems very utopic. Maybe the best example is giving the consent for personal data processing by simply clicking at some Internet site– clearly despite of having all the instruments offered by the GDPR on disposal, the personal data that are given can hardly be controlled and even if such option is possible in the theory, it cannot be expected that it would be used on the regular basis. Therefore it is not so surprising to hear that there are also some views very different from those expressed in the official documents of the EU authorities where GDPR is presented as the revolutionary step in the personal data protection that would help both the individuals and the companies in the challenging environment to effectively protect data. In any case, the implementation of the GDPR in practice should always begin and end with the idea of privacy as fundamental right that should be at stake only exceptionally. The awareness of this principle is crucial for ensuring that the GDPR does not become dead letter, but the live instrument of data protection.

LITERATURE:

1. Robinson N. et al. (2009). Review of the European Data Protection Directive. Cambridge: Rand Europe.
2. Kaplan H.L., Cowing M.W., Egli G.P. (2009) A Primer for Data-Protection Principles in the EU. Shook, Hardy & Bacon L.L.P. Retrieved 20.05.2017. from file:///C:/Users/KOMP1/Downloads/APrimerforDataProtectionPrinciples.pdf
3. Koops B. (2014). The Trouble with European Data Protection Law. International Data Privacy Law. Retrieved from https://www.google.hr/search?q=the+trouble+with+european+data&oq=the+trouble+with+european+data&aqs=chrome..69i57j0j69i60.9543j0j7&sourceid=chrome&ie=UTF-8

4. Le Déaut, J. (2017) Technological convergence, artificial intelligence and human rights. (2017) Retrieved 15.05.2017. from http://assembly.coe.int/nw/xml/XRef/Xref-DocDetails-EN.asp?lang=EN&FileId=23531
5. Marr, B. (2017) Using your personal data is now second nature for politicians. Retrieved 15.05.2017. from https://www.google.hr/search?q=Using+your+personal+data+is+now+second+nature+for+politicians&oq=Using+your+personal+data+is+now+second+nature+for+politicians&aqs=chrome..69i57.3975j0j4&sourceid=chrome&ie=UTF-8
6. Pink, S. et al. (2016) Data Ethnographies (1): personal data in an uncertain world. Retreived 20.05.2017. from: https://dataethnographies.com/paper-i-personal-data-in-an-uncertain-world/
7. Thordarson, J. (2015). Managing eDocuments under the new EU Data Protection Regulation. Retrieved 20.05.2017. from http://www.eudataprotectionregulation.com/single-post/2015/04/17/Managing-eDocuments-under-the-new-EU-Data-Protection-Regulation
8. Yaros, O. (2015). UK: The General Data Protection Regulation: The status Of The Negotiations To Implement A New data Protection Law Throughout Europe. Mayer Brown. Retrieved 20.05.2017. from https://www.mayerbrown.com/files/Publication/7c11aee8-831e-41f1-a09a-7108f91a4bda/Presentation/PublicationAttachment/c939e2b2-01e7-49ab-b60a-7146663be71d/GeneralDataProtectionRegulation_BTS_Review-I22_Fall-2015_V14-5.pdf
9. (2014.) Handbook on European data protection law. Retrieved 26.05.2017. from http://www.echr.coe.int/Documents/Handbook_data_protection_ENG.pdf

ADDRESSING THE LACK OF DIVERSITY IN THE LEGAL PROFESSION, AT THE UNDERGRADUATE LEVEL

Troy Romero
University of Nebraska – Omaha, USA
tromero@unomaha.edu

Michael Carroll
University of Nebraska – Omaha, USA
mcarroll@unomaha.edu

ABSTRACT

The study and practice of law is among the most respected and well-regarded pursuits; unfortunately, it is also among the least diverse. The persistent and alarming lack of diversity is prevalent in the industry regardless of the culture. In the United States and in Europe, statistics show that lawyers are overwhelmingly comprised by white males, especially in the higher ranks of the profession. Several factors contribute to this lack of diversity, including access to legal professionals and costs associated with pursuing a legal degree. Several strategies have been initiated to increase diversity in the field, including increasing awareness of the issue in the legal world and actively recruiting diverse populations, yet the lack of diversity persists. This paper will review some of the factors that contribute to the lack of diversity in the legal profession and strategies considered to increase diversity, and ultimately highlight a program that initiated one such strategy – a pre-law program developed to increase knowledge of the legal profession, access to legal professionals, and financial and academic support for the pursuit of a legal career for undergraduate students. The remainder of this paper will outline specifics of the pre-law program, including its student demographics that include over 60 students with very diverse backgrounds, its law-related activities/programming that include presentatons from law students and professions, law school visits, and workshops on applying for law school and writing personal statements, and its achieved outcomes since its inception in 2009 that include formative partnerships with regional law schools and legal organizations, student scholarships, and graduated attorneys.

Keywords: *Education, Knowledge Management, Diversity, Legal Profession, Undergraduate*

1. INTRODUCTION

It has been well established that the legal profession is in need of diversity. In fact, it has been claimed to be the least diverse white collar profession (4, 13). The U.S. Census Bureau corroborated this claim on several fronts with a report in 2017 (2). They compared demographics in the legal field from 2007-2017 and found that the percentage of White lawyers was significantly his, as high as 81% in 2013. While this number has improved recently (66.6% of the attorneys are White in 2017), fewer than 40% of the total number of lawyers are represented in the polling sample. The percentage of minorities has increased among associates over the last few years, but this is mostly attributed to the increase in the Asian population (11). In fact, from 2007 to 2017, there has been little change among the percentage of African American and Hispanic attorneys (3.2-4.1% and 3.1-3.9%, respecctively; 2). The discrepancy is even larger among the higher ranks of the profession; only 7.52% of the partners of the major U.S. law firms are minorities, and only 5.6% are equity partners (11).The lack of diversity is not just along ethnic lines. The percentage of women attedning law school has been increasing over the last two decades, and, according to the American Bar Association (1), last year women made up the majority of law students in

the United States for the first time ever. Despite the increasing number of women in the profession, women remain considerably underepresented, making up only 35.3% of the attorneys (7), 24% of the general counsels among Fortune 500 companies and only 22% of equity partners in major law firms are women (7). As would be expected, women of color are face the double bind, which is reflected their represenation in the legal field. In fact, only 10.5% of African American women and 5.7% of Hispanic women were general counsel for Fortune 500 companies (6), and only 1.5% of minority women are partners in major U.S. law firms (10). The factors listed above are not unique to the United States. According to Swain (15), there are several similar, if not identical, factors that lead to the same persistent lack of diversity in law in the UK. In fact, in Elitist Briatin, a report commissioned by the the Social Mobility and Child Poverty Commission (14), it is reported that that 71% of senior judges went to independent schools while 75% went to Oxbridge, as compared to 7% and 1%, respectively, of the general population. Similar to the U.S., more women than men are attending law school and becoming solicitors, and minorities comprised only 32% of law students in the UK (9), still they are under represented among senior lawyers. According to a QCs Geoffrey Bindman and Karon Monaghan (16) report found that women account for no more than 38.3% of legal positions, with the lowest percentages among the higher level positons (e.g., women only accoung for 25.3% of the judicial posts, 17.3% of senior judiciary, and 15% of the high court judges). The data on ethnicity from the same report acknowledged that the results are unreliable for many reasons (e.g., ethnicity was requested voluntarily, so not all individuals provided the data; there was no set template for which to catagorize ethnicity, so there are inconsistencies in profiles, etc.). However, with that said, that data that was provided indicates that, similar to women, minorities are better represented among lower levels of the profession. 5.8% of the judicial office holders are minorities, just 1 out of 106 of the high court judges identified as a minority (0.94%), and there were zero current or past minority members in the Surpreme Cour, Court of Appeal, or Head of Division.

2. CHAPTER – FACTORS CONTRIBUTING TO THE LACK OF DIVERSITY

Identifying the contributing factors for the lack of diversity in the legal profession is difficult, mostly because there are several overlapping elements that work together to create a composite result. Bell (8) outlined three factors. First, she stated that while most firms have a structure in place to promote diversity (i.e., diversity committees, recruitment and retention programs, etc.), there is still bias (implicit or otherwise) in assigned work and performance evaluations that hinder the development and advancement lawyers with diverse backgrounds. This factor is supported by Swain (15), who states that the success of recruitment strategies is not readily present, particularly among the top echeolon of the profession. Second, the lawyers who tend to have the most influence in firms are those with the largest »books« and their success in their career allows them the lattitude to pick with whom they work. Their motivation to continue their success will be more influenced by what they beleive will lead to success and choose to work with lawyers who reflect their own values – the goal of different viewpoints and diversity may not be a focus. In fact, it is not easy to convince people to not recruit people who look different than them (15). Third, the lack of diversity in firms can lead to a »downward spiral,« an idea that the current lack of diversity suggests a lack of opportunties for those with diverse backgrounds, which ultimately affects hiring and retention. The landmark study from the American Bar Association Commission on Women in the Profession, Visible Invisibility: Women of Color in Law Firms (3) surveyed lawyers, which included women and men of diverse ethnic backgrounds, and identifed several issues that undoubtedly are contributing factor to the lack of diversity as it pertains to women in the field. For example, compared to white males, significantly higher percentages of women of

color felt their career commitment were doubted after having children, wanted more/better mentoring, had been denied desirable assignments, received unfair performance evaluations, were denied promotions, etc.
The sentiments of the participants in the above study are supported by Swain (15), who suggests that both an unfair playing groud as well as the institutionally influenced lowered aspirations of minorities and women in the legal field affect their confidence and actual outcomes.

3. CHAPTER – STRATEGIES TO INCREASE DIVERSITY

Despite the persistence of the problem, several strategies have been developed or suggested to counteract the lack of diversity in law. A review of the literature suggests three general strategic approaches. First, implement the critical organizational practices that create and sustain the workforce. These practices include seeking and cultivating relationships with organizations from which diverse applicants can be accessed, recruited and hired (e.g., Black and Hispanic law school and bar associations)(4, 12, 15); have a CV-blind recruitment and selection process (15); develop a top-down, zero-tolerance policy of workplace bias (4, 5); create an effective and supported diversity committee, develop concrete measurement tools to track, analyze and measure progress, and develop a succession-planning strategy that integrates inclusion (4), etc. The second general strategy is to create and cultivate a culture of inclusivity. Elements of this strategy include communicating the importance diversity (5, 12) and actively develop and encourage minorities and women to join formal and informal groups, such and formal and informal networks and mentor programs (4). A third general strategy is to build the personal locus of control among diverse individuals. As mentioned above, one of the factors that may contribute to the lack of diversity is the institutionally influenced lowered aspirations and confidence of potential lawyers, so building upon the personal wherewithall of the burgeoning lawyer is important. Several strategies for women of color in law firms were provided in the ABA (4) report, which included self-promoting statements such as »Believe in yourself, and do not let anyone shake your belief in yourself«, »It takes a village to raise a lawyer« and »Network, network, network«. Interestingly, the target of these strategies are law firms or lawyers just starting their legal career. However, not much time has been taken to evaluate strategies that target the issue earlier. Thus, the focus of the rest of this paper is to highlight a program that initiated one such strategy – a pre-law program developed to increase knowledge of the legal profession, access to legal professionals, and financial and academic support for pursuit to legal career for undergraduates.

4. CHAPTER – THE UNIVERSITY OF NEBRASKA-OMAHA PRE-LAW PROGRAM

The need to diversify the profession overall, which has been outlined above, was clearly identified by the American Bar Association as evidenced by its Diversity Plan. Locally, at least to the authors of this paper, the Nebraska State Law Association and the Nebraska Minority Justice Committee led a call of action to increase the diversity of Nebraska, which resulted in a collaborative effort to create the University of Nebraska–Omaha (UNO) Pre-Law Support Program. The program was organized to assist and advocate for students, focusing on but not limitied to students with diverse backgrounds, of UNO in becoming more knowledgeable about the legal profession (i.e., evaluating the varying occupations available in the profession, understanding and navigating the process of getting into law school, paying for law school, preparing for law school, and so on), and it held its first official meeting on July 9, 2009. Since its inception, the program has served over 60 students with very diverse backgrounds, including ethnic, gender, and geographic diversity. While all students are

welcome to participate in the program, most of the participants were recurited from two areas: the Goodrich Scholarship Program and Project Acheive. Both programs are similar in their missions are to provide resources to at-risk students in their pursuit of a bachelor's degree. The Goodrich Scholarship Program is a state-funded program that selects approximately 65 students a year from a pool of over 600 applicants based on financial need and academic merit; recipients of the scholarship receive what is almost equivalent to a full-ride scholarship (more about the Goodrich Scholarship Program can be found at https://www.unomaha.edu/college-of-public-affairs-and-community-service/goodrich-scholarship-program/index.php).

Project Achieve is a federally funded program that provides additional support to students who qualify as first-generation college students, have financial need, and/or have a disability (more about Project Achieve can be found at https://www.unomaha.edu/project-achieve/index.php). Because of the qualifications of the two programs, the student population of the pre-law program is rich with diversity. In its first year, the program started with one participant and had limited programming, consisting mostly of workshops coordinated by the co-directors/authors of this paper. However, since its inception, the program has grown in several way. The activities and programming of the pre-law program have been specifically designed to reach its desired goals and can be summarized in six categories. These categories and specific examples of each category are illustrated in *Table 1*.

Table 1: Pre-Law Programming – (Ends on the next page)

Presentations from current law students	• Legal Study Abroad (Lucia Marquez, Esq.) • The Law School Experience from Start to Finish (Jacob Stodola, Esq.)
Presentations from visiting scholars/lawyers	• Law and Activism, Constitutional Law, Environmental Law, and Labor Law (Gamelyn Oduardo Sierra, JD, from the University of Puerto Rico) • Ins and Outs of Law School (Erica Buenrostro, Esq. &Yvonne Sosa, Esq.) • Tribal Law and the Environment (Leonica Charging, J. D.) • A lecture on Tinker v. the Des Moines School Board, by plaintiff Mary Beth Tinker • A presentation by U.S. Circuit judge of the U.S. Court of Appeals for the Eighth Circuit Jane Kelly
Professional/Practicing Lawyer Panels	• A panel on immigration law at the offices of Justice for Our Neighbors, including Emiliano Lerda, Esq., Sean Ellison, Esq., Jose Lopez, Esq., and Raul Guerra, Esq. • A program on Gideon v. Wainwright, co-sponsored by the U.S. Courts Library and the Creighton University Klutznick Law Library
On-Site Events	• Mock *voir dire* (witness selection) at Dornan, Lustgarten, and Troia, LLO • Honors receptions and panel discussions at Baird Holm • Practice LSAT administration and workshops at UNO, coordinated with Dr. Laura Grams, UNO pre-law advisor • Several events at Creighton University, including Moot Court Competition visits, the Pre-Law Expo, NSBA's

	Diversity Summit, and meeting of the NE Supreme Court • Law School presentations from Drake, Washburn, Creighton, and UNL at UNO • Law School visits and tours (e.g., annual NU trip)
Workshops	• Application Workshops for scholarship and law school applications • Résumé and Personal Statement Workshops for scholarship and law school applications
Liaisons	• Phi Alpha Delta (PAD), UNO's pre-law fraternity • UNO Pre-Law Advisement, housed in College of Arts & Sciences • TWC (Thomas W. Carroll) Pre-Law Support Initiative

In addition to the expanded programming, the pre-law program has cultivated partnerships with local law firms who provide guidance and mentorship to our students. Currently, one of the partnering firms has collaborated with the program to provide financial awards to support active and distinguished members of the cohort in their pursuit of a legal career. To date, over $15,000 have been raised to support students. The program has also develoed inroads to other programs that are dedicated to the same or similar mission. Specifically, this program has leveraged the support and resources of the Nebraska State Bar Association (NSBA). The NSBA annually provides a scholarship that covers the cost of the LSAT prepartory courses. In the last seven years, 12 members of the cohort have earned NSBA LSAT Preparatory Scholarship. Probably the best measure of success for a pre-law program is the number of participants who successfully enrol and graduate from law school. Since 2011, the program has grown to between 15-24 participants annually. Because the focus of the program is to assist and advocate for students interested in law, it should not come as a surprise that some students find that pursuit of a legal career is not for them. For these students, we feel our program has been successful because our intent it to give our students »access« so that they can make an informed decision – if this decision leads them away from law, it is a win. However, if that informed decision continues them on their path, then applying for, being accepted to, and ultimately graduating from law school is a clear success. In this respect, the program has had 19 students accepted into law school, 13 of which have already successfully graduated with their Juris Doctorate.

5. CONCLUSION

Although the UNO Pre-Law Program is still a work in progress, it has made significant head way in addressing the lack of diversity in the legal profession. Its strategy is different than many that are suggested in the legal literature, but the early results are promising. While the fruits of this labor will take some time to be seen, we are proud of the immidediate impact the UNO Pre-Law Program has had. In fact, last year, the program was recognized for its efforts by the Nebraska Bar Association with the 2016 Diversity Award.

LITERATURE:

1. ABA Law School Data: JD Matriculant Data, Fall 2016 (2016). Retrieved 06.04.2017 from https://www.americanbar.org/groups/legal_education/resources/statistics.html
2. ABA National Lawyer Population Survey: 10-Year Trend in Lawyer Demographics. (2017). Retrieved 03.04.2017 from https://www.americanbar.org/content/dam/aba/administrative/market_research/National%20Lawyer%20Population%20Demographics%202007-2017.authcheckdam.pdf

3. American Bar Association Commission on Women in the Profession. (2006). *Visible Invisibility: Women of Color in Law Firms*. Retrieved 18.04.2017 from https://www.americanbar.org/content/dam/aba/migrated/women/woc/visible_invisibility.authcheckdam.pdf
4. American Bar Association Commission on Women in the Profession. (2008). *From Visible Invisibility to Visibly Successful: Success Strategies for Law Firms and Women of Color in Law Firms*. Retrieved 20.04.2017 from https://www.americanbar.org/content/dam/aba/marketing/women/visibleinvisibility_vs.authcheckdam.pdf
5. American Bar Association Commission on Women in the Profession. (2012). *Executive Summary, Visible Invisibility: Women of Color in Fortune 500 Legal Departments*. Retrieved 20.04.2017 from https://www.americanbar.org/content/dam/aba/marketing/women/visible_invisibility_fortune500_executive_summary.authcheckdam.pdf
6. American Bar Association Commission on Women in the Profession. (2014). A Current Glance at Women in the Law. Retireved 03.04.2017 from https://www.americanbar.org/content/dam/aba/marketing/women/current_glance_statistics_july2014.authcheckdam.pdf
7. American Bar Association Commission on Women in the Profession. (2017). A Current Glance at Women in the Law. Retireved 03.04.2017 from https://www.americanbar.org/content/dam/aba/marketing/women/current_glance_statistics_january2017.authcheckdam.pdf
8. Bell, J. (2016). *Why law is the least diverse profession*. Law 360, 2016. Retrieved 23.04.2017 from https://www.law360.com/articles/795764/why-law-is-the-least-diverse-profession
9. HESA. (2013). *Introduction – Students 2012/13*. Retrieved 11.04.2017 from https://www.hesa.ac.uk/data-and-analysis/publications/students-2012-13/introduction
10. NALP. (2008). *Law Firm Diversity Demographics Slow to Change — Minority Women Remain Particularly Scarce in Law Firm Partnership Ranks*. Retrieved 01.04.2017 from http://www.nalp.org/lawfirmdiversity
11. NALP. (2017). *Diversity Infographic: Minorities*. Retrieved 01.04.2017 from - http://www.nalp.org/nalpdiversityinfographic_minorities
12. Robinson, S. (2016). Answering the Call for Diversity in the Legal Profession (Perspective). *Bloomberg Law: Big Law Business*. Retrieved 01.06.2017 from https://bol.bna.com/answering-the-call-for-diversity-in-the-legal-profession-perspective/
13. Rhode, D. L. (2016). *Women and Leadership*. New York: Oxford University Press.
14. Social Mobility and Child Poverty Commission. (2014). *Elitist Britain*. Retrieved 11.04.2017 from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347915/Elitist_Britain_-_Final.pdf
15. Swain, H. (2015). *Where is the diversity in law recruitment?* The Guardian, 2015. Retrieved 11.04.2017 from https://www.theguardian.com/law/2015/jul/14/where-is-the-diversity-in-law-recruitment
16. QCs Geoffrey Bindman and Karon Monaghan. (2014). *Judicial Diversity: Accelerating Change*. Retrieved 11.04.2017 from https://jac.judiciary.gov.uk/sites/default/files/sync/news/accelerating_change_finalrev.pdf

DIGITAL CONTENT AS A MARKET COMMODITY SUI GENERIS: EU LAWYERS (FINALLY) MOVING FROM NEWTON PHYSICS TO QUANTUM PHYSICS?

Janja Hojnik
Associate Law Professor, Jean Monnet Chair
University of Maribor, Faculty of Law, Slovenia
janja.hojnik@um.si

ABSTRACT

This paper responds to a growing number of demands by governmental and non-governmental organisations that call upon the EU institutions to level the legal treatment of digital content and physical goods. On this basis, consequences of treating digital content as analogous to physical goods are considered in certain legal fields, where it has recently been demonstrated that the categorisation of digital goods is of paramount legal importance, most notably in the field of copyright, taxation, and consumer protection law. Consequently, certain conclusions are made on the justifiability of the aforementioned calls for the legal unification of digital and physical goods.

Keywords*: digital content, EU law, goods, services, copyright, taxation, consumers*

1. INTRODUCTION

In 1980 Hunnings compared sending the Financial Times newspaper from London to Frankfurt by post and by fax and claimed that the means of transportation should not have made a considerable difference in the legal consequences. He was critical about old-fashioned thinking of lawyers when dealing with new technologies, thereby saying:

"We are faced in reality with two different forms of transportation (...) The end result is exactly the same: the physical object in London has been transported into the hands of the recipient in Frankfurt. The conceptual blockage which prevents this equivalence being acted upon is the lawyer's reluctance to move from Newtonian physics to quantum physics, an inability to attribute physical characteristics to anything that cannot be held in the hand and thus an unwillingness to accept that one can "import" electronic signals."(March Hunnings, 1980, p. 568)

Hunnings' call for unification was not responded to for many years following his comments. Nevertheless, recently the topic became more relevant than ever before as the European Commission has defined the completion of the Digital Single Market as one of its ten political priorities. At the centre of the Digital Single Market are digital goods or digital content, a broad and rapidly–expanding term in view of the variety of "goods" actually covered, referring to all goods that are stored, delivered and used in its electronic format, such as smartphone applications, digital music and books, computer design files for 3D printed products, for instance houses, medical devices and food. As such digital content may be distinguished from physical (or analogue) goods that refer to material things with physical dimensions, but also from services that were traditionally considered as something that cannot be stored nor owned. Therefore, digital content bring a broad range of legal challenges in respect of whether they should legally be treated as physical goods or as services – or, alternatively, as a *sui generis* concept and what consequences this would bring – *inter alia* in the field of copyright, taxation, and consumer protection law.

This paper responds to a growing number of demands by governmental and non-governmental organisations that call upon the EU institutions to level the legal treatment of digital content and physical goods. On this basis, consequences of treating digital content as

analogous to physical goods are considered in certain legal fields, where it has recently been demonstrated that the categorisation of digital goods is of paramount legal importance, most notably in the field of copyright, taxation, and consumer protection law. Consequently, certain conclusions are made on the justifiability of the aforementioned calls for the legal unification of digital and physical goods.

2. IS DIGITAL CONTENT ACTUALLY GOODS OR SERVICES?

A common, non-legal definition describes the term digital goods as a *"general term that is used to describe any goods that are stored, delivered and used in its electronic format. Digital goods are shipped electronically to the consumer through e-mail or download from the Internet"* (Webopedia, Digital goods). The 2011 EU Consumer Rights Directive (2011/83/EU) uses the term "digital content", which is defined as *"data which are produced and supplied in digital form"*. Its preamble (rec. 9) provides the following examples: *"Digital content means data which are produced and supplied in digital form, such as computer programs, applications, games, music, videos or texts, irrespective of whether they are accessed through downloading or streaming, from a tangible medium or through any other means"*.

In line with this, commentators normally draw a distinction between digital products supplied in physical form and those supplied entirely digitally, e.g. by Internet download. Situations may vary to a great extent: the online purchase of a book is a digital transaction, which does not involve the supply of a digital product; on the other hand, the download of the book to be read as an e-book involves digitally contracting for the digital delivery of a digital product. Again, the online purchase of a CD, involves digital contracting for the physical delivery of a product, which may be regarded as digital or physical, whereas one may also purchase software in a local computer store (Bradgate, 2010, p. 12). Finally, we are currently witnessing the development of "cloud computing" which, rather than supplying the consumer with a copy of the program, involves the software supplier allowing the consumer to access the program supplier's server via the Internet to obtain the product (Emma Gallacher & Sean Jauss; Gary Graham, Bernard Burnes, Gerard J. Lewis, & Janet Langer, 2004; Kryvinska, Kaczor, Strauss, & Greguš, 2014; Glenn Parry, Bustinza, & Vendrell-Herrero, 2012). Thus, this new process more closely resembles the supply of a service than a contract for the supply of goods (Bradgate, 2010, p. 14).

This broad spectrum of forms in which digital goods exist is also reflected in the EU Court's case law. In general, if digital goods are not related to a tangible entity, rules on services will apply; if they do, rules concerning goods will apply. In *Sacchi* (case 155/73), the EU Court held that, *"the transmission of television signals, including those in the nature of advertisements, comes, as such, within the rules of the Treaty relating to services"*. The next paragraph of the judgment deals with trade in materials (tapes, film etc.) used for television programmes, which are covered by the rules relating to the movement of goods. This ruling is still good law as evidenced by the EU Court's more recent decision in *Dynamic Medien* (case C-244/06) where Germany prohibited sale of DVDs or video cassettes with cartoons without an age-limit label corresponding to a classification from a higher regional authority. The EU Court considered the case under the free movement of goods rules, finding the national rules to be measures having equivalent effect to quantitative restrictions that are prohibited by Article 34 TFEU (European Commission, 2010; Koutrakos, Shuibhne, & Syrpis, 2016; Oliver, 2010). In contrast to this, however, in *Football Association Premier League ('the FAPL' – case C-403/08)* the EU Court treated prohibition of the importation of foreign decoding devices under free movement of services rules – considering that the decoding devices merely provide access to the signal, which enables the broadcasting services. The EU Court held that national legislation, which prohibited the import, sale or use

of foreign decoder cards, was contrary to the freedom to provide services (Ben Van Rompuy, 2014). It explained that *»the national legislation is not directed at decoding devices, but deals with them only as an instrument enabling subscribers to obtain the encrypted broadcasting services.«* Rules on the free movement of goods were, thus, not applied. On the other hand, however, the *UsedSoft* case (C-128/11) was decided using principle of exhaustion that has until then been applied only to physical goods although it referred solely to the downloading and storing of software on customers' computers. In Usedsoft the EU Court recognised ownership rights (traditionally only attributable to physical goods) in relation to software and accordingly extended the principle of exhaustion developed under free movement of goods rules to software. This conclusion was based on the EU Court's establishment of an EU wide definition of the term sale: *"an agreement by which a person, in return for payment, transfers to another person his rights of ownership on an item or tangible or intangible property belonging to him" (para. 42)*. Furthermore, the EU Court made numerous arguments about the principles of equivalence between digital and physical goods (more on the principle of equivalence in Reed, 2010; Schellekens, 2006). In particular, it ruled that it made no difference whether the copy of the computer program was made available to the customer by means of a download or a physical CD or DVD and that the online transmission method was the "*functional equivalent*" to the supply of a material medium.

Bradgate supports this categorisation by stating that *"provision of a service involves doing something. Therefore making downloads available at a website involves the provision of a service; but the download itself is not a service within this definition; it has much more in common with a 'thing', albeit an intangible one, and therefore (…) a download is not in itself an activity but is closer to the concept of goods"* (Bradgate, 2010, para. 159) Furthermore, Dreier agreed that *"it is of secondary importance whether the offering is conducted offline or online"*(Dreier, 2013, p. 138).

In contrast to this, in *Commission v Luxembourg and France* (case C-479/13), the EU Court denied affording digital books the same VAT status as afforded to the "*supply of books on all physical means of support"* for which Member States may apply a reduced rate of VAT, despite the fact that digital books also need a physical apparatus (such as a computer) to be read. The Court established that the reduced rate of VAT is applicable to a transaction consisting of the supply of a book found on a physical medium. While the Court admitted that in order to be able to read an electronic book, physical support is required, such support is, according to the Court, not included in the supply of electronic books, meaning that Annex III does not include the supply of such books within its scope. Moreover, the Court found that the VAT Directive excluded any possibility of a reduced VAT rate being applied to 'electronically supplied services' and held that the supply of electronic books is such a service.

What can be established from the foregoing is that the EU Court is not taking a uniform approach towards digital goods, but rather treats them alternately as goods and services. It is understandable that when determining the legal categorisation of digital goods the EU Court (as well as the Commission) do not only examine objective characteristics of digital goods, but also consider the broader result they want to achieve through their case law and proposals of EU legislation. In line with the Court's elementary *modus operandi* one can conclude that when the Court was called upon to interpret the principles of EU law (e.g. the principle of exhaustion that is supporting free movement of goods on the internal market and limiting copyright) it was open to broaden the definition of the term "goods" so as to cover digital goods. In contrast, however, when the Court was called upon to interpret derogations to the principles of EU law it followed its established maxim of interpreting the derogations narrowly, thereby not allowing the broadening of the national autonomy in certain fields, which could lead to the partitioning of the internal market (such as a reduced rate of VAT),

from physical goods to the digital ones. This varied approach of the EU Court towards classification of digital goods undeniably has several relevant legal consequences that are examined in the following chapter.

3. LEGAL CONSEQUENCES OF THE GOODS/SERVICES DISTINCTION FOR DIGITAL GOODS

Recently, it became particularly relevant as to whether digital goods should be considered on equal footing with physical goods in specific fields, such as copyright, taxation, and consumer protection law. The following chapters briefly analyse legal consequences of (not) treating digital goods as physical goods in these three legal domains.

3.1. Exhaustion of copyright

One major issue of digital goods that is dependent upon its classification as goods or services concerns exhaustion of copyright under EU law (on the historic origins of the principle of exhaustion in the EU, see Schovsbo, 2010, p. 174; Westkamp, 2007, p. 291). The principle of exhaustion provides that a copyright owner's right to control copies of their work "exhausts" on its first sale by the copyright owner or with their consent. The principle prevents the copyright owner's right to control copies of their work following the first (authorised) sale of the work thereby prohibiting interference into purchaser's property rights and allowing the purchaser to have control over their copy. This includes the right to resell it free from interference by the copyright owner (Clugston, 2013). As found by Rub, copyright exhaustion serves an important social function of reducing information costs – without it, buyers will need to inefficiently waste resources inquiring whether they will be able to resell copyrighted work (Rub, 2015).

The EU developed the principle of exhaustion primarily from the perspective of enshrining the free movement of goods throughout the EU and standardising the approach across EU Member States (Forrester, 2000; Koutrakos, 2003). This was achieved through the Copyright Directive (also called "the InfoSoc Directive" - 2001/29/EC), as well as by the Software Directive (2009/24/EC), which applied the principles of the Copyright Directive to computer programs, including games and software. There are, however, differences between the two Directives – most notably, the absence in the Software Directive of recitals 28 and 29 of the Copyright Directive. Recital 28 states that protection relates to works incorporated in a tangible article (e.g. a CD-ROM), and that first sale exhausts the right to control resale of that object in the EU. Recital 29 specifically states that exhaustion does not arise in relation to services and on-line services (more in Spedicato, 2015). These provisions reflect the fact that exhaustion is based on the distinction of the rights in the immaterial work and the transfer of material copies of the work which are traded as goods (Wiebe, 2009). Speaking of the 1991 Copyright Directive, the Commission stated that:

*"As to the exhaustion of copyright it must be borne in mind that under the Directive Community exhaustion only applies to the sale of copies i.e. goods, whereas supply through on-line services does not entail exhaustion" (*Debates of the EP (EN ed.) No. 466, p. 174). Consequently, the exhaustion doctrine, as envisaged and developed by the EU Courts, had up until the *UsedSoft* ruling been applied only to physical copies of a work. As pointed out by Spedicato, however, *»there is no reason why this principle should become any less necessary in the online distribution of intangible copies«* (Spedicato, 2015, p. 32). Nevertheless, the digital context brings difficulties for this doctrine as it is not the original copy being passed along, but a new one (Linklater, 2014, p. 13). In *UsedSoft*, despite Oracle's use of the word "licence" and their determination that it was a true software licence, the EU Court decided that concluding the grant of a continuous licence with a maintenance agreement and downloading a copy of the software formed an indivisible whole transaction which amounted

to *a sale* capable of exhausting Oracle's right of distribution to the sold copies of the software. The EU Court reasoned that, as the right of distribution had been exhausted, it was impossible for the right holder to object to any subsequent transfers of the software (para. 68). To limit the application of the principle of the exhaustion solely to copies of computer programs that are sold on a material medium would, according to the EU Court, allow the copyright holder to control the resale of copies downloaded from the internet and to demand further remuneration on the occasion of each new sale, even though the first sale of the copy had already enabled the right holder to obtain an appropriate remuneration. Therefore, any second-hand acquirer must also be a lawful acquirer with the right to reproduce the program for the purposes of its intended use. To reinforce the aforementioned *"functional equivalents"* towards online-offline transmission, the EU Court advised that, in practice, the original acquirer would have to make their own copy unusable for resale, just as it would be if the program was sold on a tangible medium.

While Stothers notes that the ruling in Usedsoft shows *"a continuing commitment by the ECJ to ensure that technological change does not reintroduce territorial restrictions in Europe"* (Stothers, 2012, p. 789), Torremans concludes from this judgment that copyright is obviously not the dominant factor in the digital era and that dominance is given to the rules on free movement and on competition law (Torremans, 2014). There has consequently been broad speculation about how this decision could impact other digital goods such as e-books and digital music. Based on the provisions of recitals 28 and 29 to the Copyright Directive, one could conclude that the EU Court's judgment in *UsedSoft* should not be extended to include other forms of digital media. Nevertheless, Targosz pointed out that in order to solve the issue of online exhaustion, *"literal interpretation will not be of much help"*(Targosz, 2010) and Linklater emphasised that *"UsedSoft signals the start of a new beginning. As we enter this brave new world, the Copyright Directive will be read anew: misalignments in the treatment of physical and digital content will be resolved (…). With UsedSoft as a precedent, the Court can do nothing but keep expanding its own ruling (…) it is only a matter of time until the digital first sale meteor strikes non-software downloads also"* (Linklater, 2014). Consequently, with the EU Court's commitment to online-offline equivalence and its establishment of an EU wide definition of "sale" to be applied to both tangible and intangible property, it has been put forward that the EU Court will also interpret the Copyright Directive exhaustion provisions as applying to tangible and intangible property in the future (Gallacher & Jauss, 2014).

Nevertheless, in the highly anticipated *Allposters* decision (case C-419/13), the EU Court tied the principle of copyright exhaustion to a physical medium, not allowing for the possibility of exhaustion for digital content falling under the Copyright Directive (Rosati, 2015; Savič, 2015). In contrast to this, however, the EU Court's equivalent approach to digital and physical goods is further supported by its ruling in *Darmstadt (case* C-117/13), where the EU Court made no difference between the photocopying of books that are physically present in a library and the printing a digital copy of the same book. The EU Court held that the Copyright directive (2001/29/EC) does not prevent Member States from granting libraries the right to digitise the books from their collections, if it becomes necessary, for the purpose of research or private study, to make those works available to individuals through dedicated terminals. The EU Court held, however, that the right of communication, which may be held by publicly accessible libraries, does not permit individuals to print out the works on paper or store them on a USB stick from dedicated terminals – although Member States may, within the limits and conditions set by the directive, provide for an exception or limitation to the exclusive right of reproduction of right holders and thus permit library users to print the works out on paper or store them on a USB stick, provided that fair compensation is paid to the copyright holders.

Moreover, it is important to note that in the recent case *VOB v Stichting Leenrecht* (case C-174/15) Advocate General Szpunar adopted "dynamic" or "evolving" interpretation of the Directive 2006/115/EC on lending rights related to copyright, thereby taking account of the rapid technological development in this sector. This Directive provides the exclusive right to authorise or prohibit loans of books to the author; in case Member States permit public lending, fair remuneration to the authors needs to be assured. Advocate General Szpunar took the view that lending by public libraries of electronic books also came within the scope of the directive, even though the EU legislature had not contemplate the inclusion of the lending of electronic books. Advocate General thus considered electronic lending as *"the modern equivalent of the lending of printed books"* (para. 30).

3.2. Taxation

Another aspect of EU law where digital goods need to be examined in view of the goods and services distinction concerns taxation. In this field, digital goods are generally considered services, not goods. Consequently, before 1 January 2015, the supply of services between businesses (B2B services) was, in principle, taxed at the customer's place of establishment, while services supplied to private individuals (B2C services) were taxed at the supplier's place of establishment. This allowed companies like Amazon, Microsoft, Apple, and Google to set up small offices in countries with favourable VAT rates and register all their European sales there. Luxembourg's "super-reduced" VAT rate on e-books (just 3 percent) thus meant that it became home to Amazon's European headquarters. The new Directive 2008/8/EC that became effective as of 1 January 2015 intended to shut down this tax loophole being used by big firms to charge less VAT on digital goods in that it provides that telecommunications, broadcasting and electronic services provided to a non-taxable person are, in all cases, taxable at the place where the customer is located. Accordingly, although considered services, digital goods now experience the same VAT treatment as the sales of goods, where in principle the location of the buyer determines the VAT rate. Consequently, when a Slovenian company is selling CDs over the Internet to private customers in Denmark, the Danish VAT must be charged when the Danish threshold is exceeded. The same is also now true for music sold in electronic form only.

Nevertheless, VAT treatment of digital and physical goods is not completely levelled as the EU Court recently refused to afford digital goods the same VAT status as is given to paper books. In the aforementioned cases *Commission v Luxembourg and France (*C-479/13) the EU Court held that the reduced VAT rate is applicable only to transactions consisting of the supplying of books found on a physical medium and rejected the argument that the supply of electronic books constituted a supply of goods (and not a supply of services). Only the physical support enabling an electronic book to be read could qualify as 'tangible property' but such support is not part of the supply of electronic books (para. 35). The principle of equivalence between online and offline property declared in *UsedSoft* therefore does not apply to VAT.

Consequently, Members of the European Parliament have asked the Commission to take urgent action to align VAT rates for electronic books and press with those applied to paper publications (Cécile Barbière, 2015) and culture ministers of France, Germany, Poland and Italy wrote to the Commission demanding a review of the VAT regulations so they can align the tax levels for all books published in all forms. In this Declaration, the ministers asked the Commission to propose European legislation that would allow reduced tax rates of VAT for all books whether they are printed or digital. In response, the Commission recognised in its recent digital strategy that the *"complications of having to deal with many different national systems represent a real obstacle for companies trying to trade cross-border both on and offline"* and said it will explore *"how to address the tax treatment of certain e-services, such*

*as digital books and online publications, in the context of the general VAT reform" (*COM(2015) 192 final, p. 8). Under this reform, however, the Commission will have to think through not only aspects of cultural diversity in respect of various media on which culture can be offered to the people, but also environmental aspects, considering the environmental impact of paper books and newspapers in comparison to e-books and e-news. In any case, keeping the advantageous VAT position of paper books does not seem plausible in the long-term.

3.3. Consumer protection

Finally, there are also important legal consequences of affording digital products "goods or services" status under contract and consumer protection law. Under national laws of the EU Member States, it has often been accepted that a digital product falls outside the definition of goods – more often because it is difficult to apply certain provisions for the sales of goods laws to digital goods (e.g. provisions on the transfer of property and those on delivery). Nevertheless, digital content supplied to consumers may potentially cause a consumer significant damage (e.g. a bug in a program might cause loss of data in which the consumer has invested time and money causing not only economic damage, but also disappointment or distress). It is unclear, however, whether consumers who buy digital goods enjoy the same legal protection as when they purchase physical goods. In absence of appropriate legislation, it has been left to the courts to establish the standards of consumer protection in situations, when they were buying digital goods by applying pre-digital age legislation (Bradgate, 2010, pp. 7–10).

Despite this conservative approach of lawmakers in Europe, the 2011 EU Consumer Rights Directive has made a step forward in this field by consolidating specific rules on pre-contractual information, formal requirements and the right of withdrawal. Nevertheless, the Directive does not treat digital products as goods or as services, rather as *"contracts for the supply of digital content which is not supplied on a tangible medium"* which are distinguishable from sales contracts and service contracts (rec. 19 of Directive 2011/83/EU). Although many provisions of the Directive apply generally to all types of contracts under the Directive, some rules depend on the classification of the contract - e.g. provisions on the right to withdrawal. It is particularly important, however, that in contrast to the sales and service contracts the Directive does not mention 'payment' as an essential term for online digital content contracts, meaning that the Directive for example applies also to a contract for a free download of a game from an app store. This "omission" is vital considering that consumers are often offered "free" content in exchange for personal data that are, consequently, monetised (BEUC, The European Consumer Organisation, 2012, p. 7). The 2015 proposal for a directive concerning contracts for the supply of digital content continues along this path by regulating contracts established in exchange for data, thereby providing that if a consumer has obtained digital content or services in exchange for personal data, the supplier must refrain from using such data in case the contract is terminated.

However, adaptation of consumer law to "the digital age" as announced in the Commission's Consumer Agenda (COM (2012) 225 final), has not been achieved in areas such as legal guarantees and unfair contract terms. As recognised by the Commission itself in its recent Digital Strategy (COM(2015) 192 final), "*when it comes to remedies for defective digital content purchased online (such as e-books) no specific EU rules exist at all, and only few national ones*." The Commission therefore announced putting forward "*clear contractual rules for online sales of both physical goods like shoes or furniture and digital content, like e-books or apps"*. This should create a level-playing field for businesses and boost consumer trust in online purchases. It was hoped, however, that this strategy would include continuing the modernisation processes started with the Consumer Rights Directive and not just going

further with the proposed but later withheld Regulation on a Common European Sales Law (CESL, COM (2011) 635 final). The latter indeed constituted an important step forward in terms of guaranteeing legal certainty in relation to digital products; the optional nature of CESL, however, did not make it sufficiently solid legislation in terms of consumer protection against defective digital content compared to the guarantees for physical goods. The same can also be said for the Commission's Communication on Cloud Computing (COM (2012) 529 final), where it has announced another optional regime for such services. In contrast to this, if the Commission actually wants to boost consumer confidence in the digital market, consumers should be given rights *corresponding* to those given to purchasers of physical goods when buying digital goods – without the need to define digital goods as goods. In this respect it may be seen as an encouraging development that in line with the Digital Strategy a proposal for a directive was published in December 2015 (COM (2015) 634 final), recommending the regulation of supplier's liability for defects with a reversed burden of proof in accordance with which it would be up to the supplier to prove that no defect existed and not vice versa. Article 6 of the proposed directive defines a defect in respect of digital content as any flaw that does not conform to *"what was promised in the contract"*. In case the contract does not make such specifications, objective criterion shall be applied, such as the circumstances that the digital content is not fit for the purpose for which it would normally be used. Consumers would have the right to terminate long-term contracts and contracts to which the supplier would make considerable changes, *without a time limit for the supplier's defect liability 'because -unlike goods- digital content is not subject to wear and tear'. Nevertheless, this regulatory development in the field of EU consumer law further evidences the complexity of digital goods and the hardships to afford them the same legal status as is afforded to physical goods or "traditional" services.* Consequently, while faulty physical goods are normally returned to the seller, this is much harder in respect of the digital goods. Article 13 of the proposed directive thus only states that the supplier shall reimburse the price or if the counter-performance consisted of data refrain from using these data, while the consumer shall refrain from using further the digital content after termination.

4. CONCLUDING REMARKS

There are an increasing number of calls to unify legal rules for physical and digital goods – by scholars (Bradgate, 2010, p. 55), consumer organisations (BEUC), MEPs and national (culture) ministers. Although the digital era considerably challenges the traditional way of legal reasoning, it may be concluded that, at EU level, the before-mentioned Hunnings' "*conceptual blockage"* in the minds of the lawyers is being increasingly overcome. The EU Court has made an important step forward in comparison to the time when electricity was the only intangible "product" treated under the free movement of goods, by establishing the principle of equivalence between digital and physical goods and by treating online and offline modes of transmission (or supply) as functional equivalents in the field of copyright. The same cannot, however, be said for the field of taxation, where digital goods are considered as services and more favourable VAT treatment of traditional paper books and newspapers than e-books and e-media is in force. It is therefore for the EU legislators to fill this regulatory gap, although it may also be admitted that the EU Court does not merely apply these sets of rules, but actively co-creates EU law, placing it in a position to contribute to progressive convergence of rules on goods and services into an integrated system of rules.

Finally, in the field of consumer protection digital goods are neither considered as goods nor as services, but as a *sui generis "product"*. Nevertheless, this special treatment of digital goods by the 2011 Consumer Rights Directive and the now withdrawn CESL corresponds to the Hunnings' call for a lawyers' "*move to quantum physics"* considering several specific characteristics of digital goods that do not correspond to some concepts of traditional contract

law. The Directive even covers digital goods that are obtained without paying a fee, taking into account the economic value of personal data normally obtained by the suppliers in exchange for the transmission of digital goods, which is admittedly an innovation that proves EU lawmakers have overcome the alleged *"conceptual blockage"*.

It may be concluded from the foregoing that despite the fact that digital goods may in certain aspects be comparable to physical goods and in other aspects to services, it is with the present state of EU law safer to treat them as a legal category *sui generis* with specific characteristics and legal consequences rather than classifying them categorically into one or the other group without examining specific characteristics of various forms of digital goods. This would lead to oversimplifications and improper legal solutions for the consumers (such as regarding the issues of payment, withdrawal and remedies). Moreover, even when it is possible to establish a level playing field for trade with physical and digital goods this should not be a one-way process in which the scope of pre-digital era rules is simply broadened to cover digital goods. *"Technology-neutral regulations"* as demanded by some EU culture ministers is thus not appropriate in every legal aspect. What is needed is an overall assessment of suitability of the established rules for the modern society in line with the values protected by the EU and with the need to establish appropriate balances among conflicting values. The central problem might be, that this balance is sometimes inconsistent, for example in *UsedSoft* the EU Court favoured internal market goals over copyright, whereas broader application of the principle of purchaser for VAT purposes as set in force since 1 January 2015 further fragmentises the internal market. Conversely, the recent EU Court's ruling that prohibits application of the reduced VAT rate for e-books and e-news supports the internal market but contravenes EU political orientations in the field of support for diversity of cultural media. The Commission's revealed Digital Strategy should thus predominantly be considered as an opportunity for an EU-wide discussion on importance of copyright, single market, culture, environmental and consumer protection in the digital era and how the established rules in these domains suit digital goods. Since these questions will be considered by various decision-making forums, it is unlikely, however, that digital goods will be categorised as physical goods within all of the relevant legal domains. The gap between the Newton and quantum world is thus likely to persist for the near future.

LITERATURE:

1. Ben Van Rompuy. (2014, May 6). Premier League fans in Europe worse off after Murphy judgment. Retrieved April 21, 2016, from
2. BEUC, The European Consumer Organisation. (2012). *Digital products: EU consumers need clear rights* (Position Paper No. X/2012/099).
3. Bradgate, R. (2010). *Consumer Rights in Digital Products*. A research report prepared for the UK Department for Business, Innovation and Skills.
4. Case 155/73, Giuseppe Sacchi, ECLI:EU:C:1974:40.
5. Case C-117/13, Technische Universität Darmstadt v Eugen Ulmer KG, ECLI:EU:C:2014:2196.
6. Case C-128/11, UsedSoft GmbH v Oracle International Corp., ECLI:EU:C:2012:407.
7. Case C-174/15, Advocate General's Opinion of 16 June 2016.
8. Case 34/79, Henn and Darby, ECLI:EU:C:1979:295.
9. Case C-244/06, Dynamic Medien Vertriebs GmbH v Avides Media AG, ECLI:EU:C:2008:85.
10. Case C-419/13 *Art & Allposters* International BV v Stichting Pictoright, ECLI:EU:C:2015:27.
11. Cases C-403/08 and C-428/08, Football Association Premier League v QC Leisure and Others and Karen Murphy v Media Protection Services Ltd, ECLI:EU:C:2011:631.

12. Cases C-479/13, Commission v France, ECLI:EU:C:2015:141 and C-502/13, Commission v Luxembourg, ECLI:EU:C:2015:143.
13. Cécile Barbière. (2015, May 20). MEPs demand urgent VAT reduction for e-books. *EurActiv.com*.
14. Clugston, C. J. (2013). International Exhaustion, Parallel Imports, and the Conflict between the Patent and Copyright Laws of the United States. *Beijing Law Review*, *04*(03), 95–99.
15. Commission's Communication, Unleashing the Potential of Cloud Computing in Europe, COM (2012) 529 final, page 12.
16. Communication from the Commission, A Common European Sales Law to Facilitate Cross-Border Transactions in the Single Market, COM (2011) 635 final.
17. Communication from the Commission, A Digital Single Market Strategy for Europe, COM(2015) 192 final, p. 8.
18. Communication from the Commission, A European Consumer Agenda – Boosting confidence and growth, COM (2012) 225 final.
19. Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services, OJ L 44, 20.2.2008, p. 11-22.
20. Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees, OJ L*171, 7.7.1999, p. 12-16.*
21. Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society, OJ L 167, 22.6.2001, p. 10–19.
22. Directive 2001/29/EC on the harmonisation of certain aspects of copyright and related rights in the information society, OJ L 167, 22.6.2001, p. 10-19.
23. Directive 2006/115/EC of the European Parliament and of the Council of 12 December 2006 on rental right and lending right and on certain rights related to copyright in the field of intellectual property, OJ L 376, 27.12.2006, p. 28-35.
24. Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs, OJ L 111, 5.5.2009, p. 16-22.
25. Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, OJ L 304, 22.11.2011, p. 64-88.
26. Dreier, T. (2013). Online and its effect on the "Goods" versus "Services" distinction. *IIC-International Review of Intellectual Property and Competition Law*, *44*(2), 137–139.
27. Emma Gallacher, & Sean Jauss. (n.d.). Exhaustion of Copyright – the impact of UsedSoft on the exhaustion of copyright in software and other digital subject matter. *Lawyer Monthly Global Expert*, *2014*, 14–17.
28. European Commission, D. E. (2010). Free movement of goods, Guide to the application of Treaty provisions governing the free movement of goods. *Publications Office of the European Union*.
29. Fiss, O. (2013). *Die Haftung für fehlerhafte Software im Wettbewerb der Rechtsordnungen: eine rechtsvergleichende Analyse*. Peter Lang.
30. Forrester, I. S. (2000). The repackaging of trade marked pharmaceuticals in Europe : recent developments. *European Intellectual Property Review*, *22*(11), 512–519.
31. Gary Graham, Bernard Burnes, Gerard J. Lewis, & Janet Langer. (2004). The transformation of the music industry supply chain: A major label perspective. *International Journal of Operations & Production Management*, *24*(11), 1087–1103.
32. Joint Declaration on TVA for E-books, http://www.euractiv.com/files/20151903_mcc-declaration-en.pdf (accessible 15 May 2017).
33. Koutrakos, P. (2003). In search of a common vocabulary in free movement of goods: the example of repackaging pharmaceuticals. *European Law Review*, (1), 53–69.

34. Koutrakos, P., Shuibhne, N. N., & Syrpis, P. (2016). *Exceptions from Eu Free Movement Law: Derogation, Justification and Proportionality*. Hart Publishing.
35. Kryvinska, N., Kaczor, S., Strauss, C., & Greguš, M. (2014). Servitization - Its Raise through Information and Communication Technologies. In M. Snene & M. Leonard (Eds.), *Exploring Services Science* (pp. 72–81). Springer International Publishing.
36. Linklater, E. (n.d.). UsedSoft and the Big Bang Theory: Is the e-Exhaustion Meteor about to Strike? *SSRN Scholarly Papers*, *2014*(2433430).
37. March Hunnings, N. (1980). Casenote on Debauve and Coditel. *Common Market Law Review*, *17*(4), 560–569.
38. Mell, P., & Grance, T. (2009). Perspectives on cloud computing and standards. *USA, NIST*.
39. Oliver, P. J. (2010). *Oliver on Free Movement of Goods in the European Union: Fifth Edition*. Bloomsbury Publishing.
40. Parry, G., Bustinza, O. F., & Vendrell-Herrero, F. (2012). Servitisation and value co-production in the UK music industry: An empirical study of Consumer Attitudes. *International Journal of Production Economics*, *135*(1), 320–332.
41. Proposal for a Directive on certain aspects concerning contracts for the supply of digital content, COM (2015) 634 final and Proposal for a Directive on certain aspects concerning contracts for the online and other distance sales of goods, COM (2015) 635 final.
42. Reed, C. (2010). Online and offline equivalence: Aspiration and achievement. *International Journal of Law and Information Technology*, eaq006.
43. Report from the Commission to the Council, the European Parliament and the Economic and Social Committee on the implementation and effects of Directive 91/250/EEC on the legal protection of computer programs, COM (2000) 199 final, referring to the answer by Commissioner Monti to Oral Question H-0436/95 by Arthur Newens, MEP (11.7.1995), Debates of the EP (EN ed.) No. 466, p. 174.
44. Rosati, E. (2015). Online copyright exhaustion in a post-Allposters world. *Journal of Intellectual Property Law & Practice*, 673–681.
45. Rub, G. A. (2015). Rebalancing Copyright Exhaustion. *Emory Law Journal*, *64*(3), 741–817.
46. Savič, M. (2015). The CJEU Allposters Case: Beginning of the End of Digital Exhaustion? *European Intellectual Property Review*, *37*(6), 389–394.
47. Schellekens, M. H. (2006). What Holds Off-Line, Also Holds On-Line? *SSRN Scholarly Papers*.
48. Schovsbo, J. (2010). Exhaustion of Rights and Common Principles of European Intellectual Property Law. *Common Principles of European Intellectual Property Law, Ansgar Ohly, Ed., Mohr Siebeck, Tübingen*.
49. Spedicato, G. (2015). Online Exhaustion and the Boundaries of Interpretation. *Balancing Copyright Law in the Digital Age*, 27.
50. Stothers, C. (2012). When Is Copyright Exhausted by a Software License? UsedSoft v. Oracle. *European Intellectual Property Review*, *34*, 787–788.
51. Targosz, T. (2010). Exhaustion in Digital Products and the "Accidental" Impact on the Balance of Interests in Copyright Law. In L. Bently, U. Suthersanen, & P. Torremans, *Global Copyright*. Edward Elgar Publishing.
52. Torremans, P. L. (2014). *The future implications of the Usedsoft decision*. CREATe Working Paper 2014/2, February 2014.
53. Weatherill, S. (2013). *EU Consumer Law and Policy*. Edward Elgar Publishing.

54. Westkamp, G. (2007). Intellectual property, competition rules, and the emerging internal market: some thoughts on the European exhaustion doctrine. *Marq. Intell. Prop. L. Rev.*, *11*, 291.
55. Wiebe, A. (2009). The principle of exhaustion in European copyright law and the distinction between digital goods and digital services. *GRUR International: Gewerblicher Rechtsschutz Und Urheberrecht Internationaler Teil*, *58*(2), 114.

APPLICATION OF NEO-MANAGERIAL APPROACH IN THE HIGHER EDUCATION SYSTEM

Jelena Dujmovic Bocka
Faculty of Law, Josip Juraj Strossmayer University of Osijek
Stjepana Radića 13, Osijek, Croatia
jdujmovi@pravos.hr

ABSTRACT

The system of higher education has significantly been influenced by the processes of privatisation, commercialisation and agentification. These processes are the main indicators that the neo-managerial approach is present in the system of higher education, as is being stated in the paper. Furthermore, the paper also presents the results of empirical research conducted on Josip Juraj Strossmayer University in Osijek regarding the rate of successfulness of Croatian higher education system reform, which also support the claim of neo-managerial approach being present. The basic hypothesis of the conducted research was that neo-managerial approach was being applied. In addition, two sub-hypotheses were formed – the first one was that privatisation, commercialisation and agentification occur as a direct consequence of applying neo-managerial approach and the second one that the approach significantly changes the way higher education system is observed as public service. The aim of the paper is to analyse the theory of (open) system which forms the basis both for the given hypothesis and the two sub-hypotheses as well as to identify key elements relevant for the system of higher education, or in other words, to point out the relevant factors that make the system the so called open system. Finally, the author's thoughts and those of anyone else interested in the matter may be related to the question: is the higher education system no longer seen as public service and to what extent?

Keywords*: agentification, commercialisation, neo-managerial approach, privatisation, the system of higher education*

1. INTRODUCTION

Public services are one of the basic elements when it comes to public administration – along with state government and local and regional self-government, and as such represent all the activities performed while having in mind the best interest of the social community. The general division of the public services differentiates between commercial and non-commercial services, making it easier to observe them in the modern European context.[1] Consequently, commercial public services are defined as those that are mostly oriented towards the market mechanisms while at the same time satisfying public interest requirements. On the other hand, non-commercial public services are defined as those that ensure that public interest requirements are satisfied and fulfilled without any intention of gaining profit from it.[2]

[1] More about introducing public service charters in an attempt to strengthen the quality of public administration by emphasizing the role of the citizens and the possibilities of them becoming a part of the Croatian public administration in: Đulabić, 2006, pp. 327-343.

[2] It is extremely important to mention some of the definitions regarding the term public services. Among these definitions, definitely includes the definitions provided by the most relevant authors in this area. The terminology we are to use is from the most distinguished author Ivo Borković. The author defines the term public service as an "administrative activity following the principles of public law". Oftentimes, Belgium is mentioned in the literature referring to theoretical part of the term public services as a country in which public service (*openbaare dienst*) is defined as a "public organism under a specific regime created by the administration in order to satisfy general interest" (one of the features that particularly stand out is the continuity of performance and respecting the principles of their users' equality). Moreover, Austria is also quite an important example since it was within its normative law school where the broadest term of public service was formed as a

Should the local community be inactive, the public services are only to deteriorate while corruptive behaviour within them is to prosper[3]. Therefore, the social community interest for public services management[4] and its protection is significantly increasing. The result of the ongoing struggle between public and private is that higher education system is no longer observed as a public service. It is rather seen as a tool used by those in power with the aim of achieving their personal benefit. The necessity for thorough public administration reform including all its key elements, starting with the state government, local and regional self-government as well as public services is the main reason for writing this paper. In other words, the author of the paper intents to contribute to administrative science development by presenting to the interested public, whether familiar with the topic or not, how the higher education system functions as a public service and how privatisation, commercialisation and agentification increasingly influence the system. [5]

2. THEORETICAL BACKGROUND

2.1. The (open) system theory

The system theory[6] is closely related to the scientist Ludwiga von Bertalanffyja (1901 – 1972)[7] and is as such, even nowadays, of great relevance when it comes to organisation. In contrast to the open system, there is the so called closed system. The differences between the systems are to be further explained later in the text. Organisation, as a closed system, is based on cause and effect principle (there is only one best way to achieve the goal), whereby the organisation analysis and observing refer to its inner aspects; as such it exchanges information with its environment and presents the way organisation is analysed. According to Vila, there has never been and there never will be a completely closed system because its elements are constantly exposed to influences coming from outside the system (Vila, 1983, p. 32). Open system organisation, on the contrary, predicts possible changes of its environment in order to ensure itself against negative influences as well as to adjust itself to the new conditions. There is a continuous communication between the system and its environment whereby emphasis is put on the equifinality principle (there are many various ways of achieving a desired state, even if the conditions are initially different); (Vila, 1983, p. 32).

2.2. Open system characteristics

What are the key characteristics of the so called open systems? The main characteristics are mainly described as: input that represents the energy coming from the system's environment, transformation process representing application, output that represents produce, services and achieved goals, a chain of events describing the system's state, negative entropy, feedback

consequence of understanding law and state identity. According to this "every person performing law is a public organ so the service performed by these organs is consequently public service". More about the definitions of public services in: Borković, 2002, pp. 12-14.

[3] Lozina and Klarić claim that new public management as administrative doctrine minimalizes the dimension of the notion administration as government – citizens. More in: Lozina, Klarić, 2003, p. 36.

[4] Đulabić claims that the most significant effort to form the concept of general interest services took place in the 1990s and in addition, points out the most important documents relevant for the topic. More details in: Đulabić, 2007, p. 148.

[5] It is quite significant to choose optimal values in the public administration that, according to Cardona and Rey, direct us towards the most suitable way to fulfil a particular mission. More in: Cardona, Rey, 2009, p. 85; 89. Another interesting categorisation of public service values referring to ethical, democratic, socail, organisational etc. can be found in: MacCarthaigh, 2008, pp. 18-20.

[6] The word system comes from Latin and means assemblage or compounding. Following this, Pusić defines the term system as a "unit comprised of parts or a unit separated from its environment" (Eisler, 1922, p. 650; referenced by Pusić, 1997, p. 5).

[7] It is important to mention his paper „The Theory of Open Systems in Physics and Biology" („Teorija otvorenih sustava u fizici i biologiji").

representing information used to correct deviations in the system's functioning, maintaining the system's boundaries by marking the boundaries separating the system from its environment, stable conditions introducing more energy to the system than it is really necessary (system growth), storage and memory for saving input so it could later be used, differentiation representing the tendency for function specialisation, assigning roles to particular groups, adaptation that represents the ability to survive in the particular environment, equifinality representing the process of achieving goals through various inputs and in different ways, and finally, tensions that are trying to be resolved as quickly as possible (the fact that the expectations, as well as behaviour of the individuals are different from those of the groups). Apart from the listed characteristics, open system also has specific disadvantages, several of which are that it is too theoretical, its characteristics have not been clearly explained and are extremely difficult to apply, as is to predict the influence of the environment and finding a suitable measure unit for it (it is easier to observe a closed system and neglect the influence of the environment) (Perko – Šeparović, 1975, pp. 89-90). Taking all the characteristics into consideration, it is to be concluded that organisation itself is not entirely enough. Having this in mind, it is rather difficult to talk, as well as to think about organisation as a closed form. Since the higher education system is an open system influenced by numerous factors, conceptual questions regarding the relevant environment in general and relevant environment of the higher education system[8] will be dealt with on the following pages of this paper.

3. RELEVANT ENVIRONMENT – CONCEPTUAL QUESTIONS

The organisational structure can be influenced by (regarding the organisational context): organisational environment, organisational technology, organisational culture, its size and communication.[9] Pusić defines the environment negatively and believes it to be "every occurrence not included in the system, but are either to be or are already relevant for the system". She considers the environment is comprised of an infinite number of elements and is as such far more complicated than the system itself is. It stands for "everything not included in the system by particular regularities, that is, all the occurrences not included in the system" or better yet "a sea of surprises as well as an unlimited source of possible intakes" (Petković, Kregar, 1994, pp. 18-19, referenced by Blažević, 2004, p. 162). The system's environment[10] is constantly changing and is as such a potential source of both positive as well as negative influences. Simply stated, everything beyond the system's boundaries is the system's environment. It can influence the system's functioning; however it is also possible that the system influences the structure and activities of the environment. Bahtijarević – Šiber emphasizes two relevant questions, based on which one can determine whether an object, an issue or an occurrence is part of the system. The first question is - Is the observed occurrence (object) relevant for the system and its functioning? The second question is – Is the observed occurrence (object) under system's control? If the answer to the first question is "yes", and to the second one "no", the observed occurrence (object) is part of the system's environment.

[8] Emery and Trist have determined four areas of mutual co-dependence within the environment: "the placid, randomized environment" – the simplest type of determinism where aims and threats are mostly stable and distributed; "the placid, clustered environment" which means that the grouped aims and threats are not randomly distributed, but are somehow linked to each other; "the disturbed, reactive environment" which assumes the existence of a larger number of similar organisations; and the so called "turbulent field of environment" which refers to the state where the system's dynamics comes not only from mutual reactions of the organisations but also form the environment itself (Emery, Trist, 1965, pp. 21-31, referenced by Perko – Šeparović, 1975, p. 91).

[9] More in: Koprić, 2006, pp. 58-83.

[10] Pusić divides the systems into: natural, technical and social. Further division refers to productive (e.g. companies), regulatory (e.g. state) and associative (e.g. church, sect etc.) (Blažević, 2004, p. 163, referenced by Pusić, 1974, p. 201).

However, if both answers are “yes” the occurrence (object) belongs to the system. Moreover, if the answer to the first question is “no”, such an occurrence (object) is not to be analysed at all since it is an irrelevant part of the system or its environment (Bahtijarević - Šiber et al., 1991, p.70).

3.1. Relevant environment of the higher education system

By using the two already formed and explained question, the author will try to further explain which relevant parts of the environment directly influence the higher education system. The parts are: a) labour market demands[11] – the fact that there are numerous strategic documents is only a precondition for making the higher education policy more successful; there are, of course, other preconditions of equal importance in order to achieve better quality in the higher education system; it is more than obvious that the enrolment quota for almost every degree program is not formed in accordance with the labour market demands and needs. The presented problem could be solved or at least partly resolved if the following recommendations were to be followed: 1 – to raise interest of the politicians for the subject matter, 2 – to continuously apply suitable strategies, 3 – to ensure constant cooperation between the faculty leadership and businessmen, 4 – to include both professional and non-professional public in debates and 5 – to find an optimal balance between the theoretical and practical part; b) the economic state of the country - Babić points out that every national economy along with its long-term development are for the most part dependant of the quality of the human capital determined by the quality of the educational system, by investing and actively taking part in education. In order to achieve long-term sustainable development each country should contribute to constant development of the its educational system and human capital, otherwise it will not prosper (Babić, 2004, p. 29). The most interesting question for the public is how much should be invested in higher education, or better said, how much money does a particular country invest in higher education as a GDP percentage? [12] Economic state in Croatia is far from satisfying, it is almost devastating. Considering this, the following questions arise: 1-what are the main reasons for the current economic situation in Croatia (possible causes)?, 2-how to solve the current economic problems in a most effective way (possible solutions)?, 3-who are the key figures to solve economic problems? It is impossible not to know the answers to the three questions. The public is through media daily exposed to various information regarding professional expertise and opinions from which they should recognize those that make the most sense. However, in order to do that one should first form one's own opinion based on what one so far knows (mostly by means of public communication – press, radio, television, internet etc.) To be able to form an opinion, not just any, but the right one, one should put a lot of effort in one's education. It is to be noticed, that education and its importance for the life of each individual is constantly being emphasized (ignorance = manipulation). We should think up a way to recover from the done damage, in particularly that regarding the higher education system. The entire economic situation has badly influenced the higher education system as well; c) access to foreign higher education systems – it is of course significant to point out the importance of accessibility of domestic higher education systems, but one should wonder, what about the accessibility of foreign higher education systems which present relevant environment of the Croatian higher education system. Is higher education available abroad? Is it attractive? Would our younger population rather study in Croatia and find work abroad? Many questions arise. The fact is that our students after finishing college in Croatia leave the country due to better employment

[11] For the purposes of this paper, we will define market as “...a group of individuals or a group of business subjects who have the need for certain produce and have the opportunity, will and ability to acquire the produce in question” (Grbac, 2010, p. 80).

[12] More in: Higher education policies – financing. Retrieved on May 4th 2017 from http://www.iro.hr/hr/politike-visokog-obrazovanja/financiranje-/.

possibilities and higher life standard abroad. [13] After Croatia joined the European Union, there has been a significant increase of mobility both of teaching and non-teaching personnel funded by the EU (for example the Tempus Program, the Erasmus+ Program etc.). We often hear how studying abroad is rather appealing (sightseeing, new friendships, different college programs etc.), however, to an average student it is far out of reach due to the displeasing financial situation. We have already been familiarized with the economic problems in Croatia, which can easily be described as everyday problems of most Croatian families. Once the economy has been strengthened, professional training of both teaching and non-teaching staff will also become more frequent and successful. Many students perceive the Croatian higher education system to be of outmost quality, but what worries them is the fact that nowadays employment is basically impossible to find (some of the main causes for this are the war that was lead in Croatia, privatisation processes, corruption, corruptive behaviour of leading politicians, lack of political will and courage to reform various parts of public administration etc.). Young people are forced to leave the country in order to find employment. The current policy to study in Croatia and to work abroad is pointless. "Brain drain" is getting worse. After having stated the mentioned problems, we might ask ourselves: Where is Croatia headed to? Are we aware of the current unemployment problem? Are we willing to face the unemployment and finally stop it? What perspective do younger people have? Do we have the will and strength to change our own consciousness in order for younger people, those who "we leave the world to inherit", to later benefit from? The questions are intended firstly for the current leading politicians, and secondly to all of us; d) future students' wishes and interests – it is a fact that in Croatia there is a variety of colleges to choose from, but their quality, however, is to be discussed. In addition to public institutions for higher education, there are also private colleges of questionable quality. Students attending public higher education institutions perceive private colleges as: an expensive way to obtain knowledge, "pay for the exam and you won't fail", low quality education, relaxed atmosphere, possibility of training abroad, emphasis is put on the practical part etc. (this is the way students see them). Whether or not this is really so, it is not on us to decide. So far, there are not any relevant scientific research conducted on this matter, but we hope they will shortly be published. Due to the Bologna Process, many consider it easier to finish college, since almost all the tests are now distributed in smaller units and are to be taken as such (the subject matter is divided into more parts so taking such a test imposes the question of quality); e) politics – when it comes to politics as a relevant part of the higher education system surroundings, the following question arises: who signed the Bologna Declaration and why? Only after answering this question, are we to gain a better insight into how influential politics in higher education systems throughout Europe really is. The Bologna Process is a notion used to describe a political intent of forming a unique higher education system in all the countries that have signed the Bologna Declaration (higher education system reform in all the Bologna Declaration signing countries). The Bologna Declaration is a document signed by twenty-nine European Ministers of Education on 19th June 1999 in Bologna[14]; f) EU integrations – should the Croatian higher education system be less under the influence of the Bologna Process? is a logical question to follow. After facing the disadvantages of implementing the Bologna Process into the higher education system of the Republic of Croatia faced with its own economic problems, the answer would definitely be "yes". But, what can we do about it? There is not a lot to be done now when the public

[13] The significance of finding motivation in order to achieve certain goals is to be pointed out here as well. More about defining motivation in: Beck, 2003, p. 24.

[14] "The Bologna Declaration" full text is available on the Agency for Science and Higher Education web pages. Agency for Science and Higher Education. Retrieved 4.5.2017. from https://www.azvo.hr/images/stories/visoko/BOLOGNA_DECLARATION1.pdf.

policies of higher education systems are trying to be as close to the great community of the European states as possible. There is only one solution. To adjust to the European standards.[15] Whether or not these standards are suitable for implementation into the higher education systems is not of anyone's concern. Croatia has become a EU member state and is obligated to accept almost every change suggested by the EU. Lead by the saying "take it or leave it", Croatia decided to accept the proposed as a chance to finally be accepted into this large community. The joining and cooperation between the member states will contribute to inter-institutional associating of higher education institutions across the EU. The emphasis is put on modernisation[16] and Europeanisation regarding the area of higher education in such a way that new trends in higher education are to be implemented along with the Europeanisation process. [17]

4. AN OVERVIEW OF THE RESULTS OF THE EMPIRICAL RESEARCH ON SUCCESSFULNESS OF HIGHER EDUCATION REFORM IN THE REPUBLIC OF CROATIA RELEVANT FOR THE MATTERS DISCUSSED IN THIS PAPER

4.1. The research aim and hypotheses

The aim of the empirical research[18] was to investigate the opinions on the rate of successfulness of implementation of the higher education reform on the Josip Juraj Strossmayer University of Osijek[19]. From the theoretical approach mentioned earlier in the paper (the open system theory) the following hypothesis was formed (along with its sub-hypotheses): H1: Neo-managerial approach is more frequently applied in the higher education system; H1a: As a direct consequence of neo-managerial approach being applied, the processes of privatisation, commercialisation and agentification occur; H1b: Due to neo-managerial approach there has been a significant change in perceiving higher education as public service.

4.2. Explanation of the hypothesis along with its sub-hypotheses

H1: Neo-managerial approach is more frequently applied in the higher education system.
This hypothesis refers to application of neo (managerial) values and techniques[20]. Neo (managerial) values mostly have an impact on students and immediate service providers. According to the Scientific Activity and Higher Education Act higher education institutions are divided into universities (faculties and art academies within their system), polytechnics, and colleges.[21] In addition to the mentioned public higher education institutions, there is an increase of private higher education institutions which ultimately means an increased number of self-employed individuals and strengthening of privatisation. This point of view promotes the understanding of the higher education institutions as private companies that follow the market principles of organisation and performance.[22] Furthermore, neo (managerial) techniques are becoming more frequently applied in the part connected with the state regulatory mechanism. The fact is that besides the Ministry of Science and Education,

[15] More about Croatian administration within the European administrative system in: Koprić et al, 2014, pp. 339-344.
[16] More about fundamental tasks within the framework of Croatian public administration in: Koprić, 2003, p. 439.
[17] More detailed description of higher education system relevant environment is to be found in: Dujmović, 2014, pp. 30-40.
[18] The entire research is available in: Dujmović, 2014, pp. 207-249.
[19] Higher education system reform refers to the Bologna Process implementation into the higher education system in the Republic of Croatia.
[20] More about administrative management in general in: Pusić, 2002, pp. 294-312, and about adjusting management styles to the existing needs in: Tudor, Srića, 1996, pp. 153-159.
[21] Detailed in: The Act on Scientific Activity and Higher Education in Croatia (NN 123/03, 198/03, 105/04, 174/04, 02/07, 46/07, 45/09, 63/11, 94/13, 139/13, 101/14, 60/15)
[22] There is a great variety of managerial skills. According to Buble, the skills are divided into: conceptual skills, public relations skills, technical skills and forming skills. More in: Buble, 2006, pp. 20-22.

numerous agencies in the field of education are being formed, so it is inevitable to mention the importance of the Agency for Science and Higher Education.

H1a: As a direct consequence of neo-managerial approach being applied, the processes of privatisation, commercialisation and agentification occur.

Privatisation[23], as a malignant process, spreads its influence over all the public administration segments including public services, and with them, the higher education system. This emphasizes the importance of the private education sector in order for the higher education service users to be able to choose where and with how much money can they buy a service they seek. Why call it a malignant process? The main reason is because it is rapidly spreading across all the segments and levels of education (not with the aim of emphasizing private initiative, but in a sense of dismantling the social state). Croatia, following the example of numerous countries, allows and encourages private participation in the higher education system without regarding the fact that by doing so, according to numerous opinions, the quality of knowledge is to deteriorate (in addition, social and pedagogical standards are to be questioned as well), the fact that state budget will in this way be less burdened should not be forgotten. Furthermore, it should be mentioned that public and private universities significantly differ from each other, one of the differences being the managerial structure which is much simpler in private universities (the emphasis is on the leadership hierarchy) as opposed to public universities whose managerial structure is much more complicated (it is based on traditional state influence, student participation etc.). In addition to privatisation, the process of commercialisation appears with the aim of introducing market logic into all the educational systems including the higher education system (higher education diploma is perceived as a product for which there is a huge demand). Apart from the two mentioned processes, it is important to mention the process of agentification seen as a process of creating numerous agencies responsible for different areas of public services, in this case, the area of higher education. It is yet to be seen whether or not will the number of the agencies grow in the future or will it remain as it is (aware of the fact that closing and/or reducing the agencies, is not popular regardless of the fact whether the agency is necessary or not).

H1b: Due to neo-managerial approach there has been a significant change in perceiving higher education as public service. It is completely acceptable to claim that the change in perceiving higher education as public service is a direct consequence of the privatisation and commercialisation processes. Prior explanation of H1a can be used in order to help explain H1b. The Constitution of the Republic of Croatia[24] proscribes that education is available to everyone, however, the influence of the mentioned processes which is constantly growing stronger, poses a question of changing the way higher education is perceived as a public service. Is the perception of higher education as a public service being changed? The exact influence of the processes of privatisation and commercialisation is yet to be seen in the near future. By applying the neo (managerial) values it is impossible to avoid the temptation to strive for profit, power and similar things. Having in mind that the stronger ones make the weaker ones their subjects and that they determine the rules, we cannot help but ask ourselves: “Who is going to win this game?!” The users of public service of higher education know the answer to this question. The relationship between administration and users should be described as a relationship user – associate, however this relationship has completely

[23] The process of privatisation can be defined in different ways depending on the context. Cvitan points out that privatisation is “the transformation of the public sector into a private company”. See in: Cvitan, 2008, p. 242.

[24] See in: Article 66 of the Constitution of the republic of Croatia (NN 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14)

vanished (only a few races of it remain). Instead, today we have the relationship user – customer (consumer)[25] successfully replacing it.

4.3. The empirical research methodology

Special emphasis is put on the data obtained while conducting empirical research on successfulness of higher education reform in the Republic of Croatia. The data has been collected by means of a questionnaire intended for teachers, assistants and students of Josip Juraj Strossmayer University of Osijek. The subjects of the empirical research were teachers and assistant working at the University of Osijek and holding one or more scientific-educational courses, and full-time students attending first, second, third, fourth, fifth or sixth year of undergraduate or graduate university studies, as well as those attending integrated undergraduate study programs. The sample consisted of 17 scientific-educational departments of the J. J. Strossmayer University in Osijek. The empirical material was presented in the form of the answers obtained from the questionnaire filled out by the already mentioned subjects and data bases made available by different public bodies and institutions. During this research, quantitative analysis method was applied; the obtained data was processed by applying the statistical method analysis.[26]

4.4. Research results

Teachers and assistants – hypothesis with its sub-hypotheses

H1: Neo-managerial approach is more frequently applied in the higher education system.

The statements presented in the questionnaire referred to the subjects' attitudes regarding the implementation of neo-managerial approach in the higher education system. 126 (84%) teachers agree with the claim that efficiency and effectiveness form the basis for the higher education system quality. Also, there is a statistically significant difference in the distribution of the obtained answers ($\chi 2$ test, $p < 0,05$) which means that the subjects have firm attitudes regarding this statement. The majority of the teachers, 55 (37%) do not agree with the claim that since 2005 when the Bologna Process was introduced in the higher education system, there has been a significant increase in the efficiency and effectiveness. However, 57 (38%) teachers also do not agree with the claim that higher education institutions adopt and adjust to the market principles of organisation and performance. Moreover, 52 (35%) teachers think that competitiveness between public and private universities is present in the higher education system. In spite of that, research subjects do not have clearly formed attitudes regarding the

[25] To find out more about the formed hypothesis along with the corresponding indicators and claims, as well as their explanations see in: Dujmović, 2014, pp. 210-217. It is a doctoral dissertation based on the research already mentioned in this paper. Other hypotheses and results obtained during this research can be found in a more detailed version in the already mentioned study "Higher Education as Public Service". The elements of neo-managerial approach can also be traced in the following regulations: State Administration System Act (NN 150/11, 12/13, 93/16, 10 4/16) and Act on Civil Servants and Civil Service Employees (NN 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)

[26] The research subjects were divided into two groups. Teachers and assistants working at the J. J. Strossmayer University of Osijek formed the first group. The second group was formed by students attending the same university. The research was conducted on 150 teachers (their position being – assistant professor, associate professor, full professor or full professors with permanent position) and assistants (both teaching assistants and senior teaching assistants). Moreover, 614 students (both from university and specialist programs) were also included in the research. The questionnaire consisted out of three parts: the first part was about personal information regarding each subject, in the second part there were twenty-three statements on which the subjects had to express their opinion by choosing one of the provided answers, while the third part was designed for subjects to express their own suggestions, remarks and compliments regarding the higher education system reform. To find out more about the research methodology and subjects see in: Dujmović, 2014, pp. 218-219; 224.

last three statements, so the distribution of answers to these questions is more or less equal without showing any statistically significant differences.

H1a: As a direct consequence of neo-managerial approach being applied, the processes of privatisation, commercialisation and agentification occur.

The statements used in the questionnaire referred to subjects' attitudes on privatisation, commercialisation and agentification occurrence within the higher education system as a direct consequence of applying neo-managerial approach. It is noticeable that the research subjects do not have an opinion regarding significant increase of the influence of the private sector on higher education system since the implementation of the Bologna Process in 2005, due to the fact that 67 (45%) teacher neither agree nor disagree with this statement. There is, however, a statistically significant difference in the distribution of answers regarding this claim ($\chi 2$ test, $p < 0,05$) which implies that there are different opinions among the tested subjects. Moreover, most of the subjects do not have a formed attitude regarding the matter of increasing the rate of participation in students' costs for those paying for their education as a consequence of the Bologna Process implementation, so 64 (41%) teachers neither agree nor disagree with this claim. In addition, the claim shows a statistically significant difference in the distribution of answers ($\chi 2$ test, $p < 0,05$). On the other hand, the subjects' attitudes referring to the claim that the quality of one's education more frequently depends on their financial abilities are evenly distributed without showing any statistically significant differences. The opinion that private universities rise their enrolment fees even though their scholarships are rather high to begin with, is neither supported nor unsupported by 74 (49%) teachers. Furthermore, 64 (43%) teachers agree with the claim that agencies within the higher education system (the Agency for Science and Higher Education, Agency for Mobility and EU Programs) are relevant for ensuring the level of quality within the higher education system. Both of the two last mentioned claims show a statistically significant distribution of answers ($\chi 2$ test, $p < 0,05$).

H1b: Due to neo-managerial approach there has been a significant change in perceiving higher education as public service.

The statements from the questionnaire referred to the subjects' attitudes about the change in perception of higher education as public service as a direct consequence of neo-managerial approach. From totally 150 teachers, a great majority, 115 (77%) think that the increase of costs students have pay for their education, will consequently result with the fact that wealthier students will be able to afford higher education. To continue, 95 (64%) teachers consider that the fact that there are more public than private educational institutions, ensures higher education system quality. Moreover, 134 (89%) teachers, which means almost everyone included in the research, think that higher education should be available to everyone under the same conditions because it is necessary for fulfilment of equal life possibilities. There is obviously a statistically significant difference in the distribution of answers regarding all the statements referring to this hypothesis ($\chi 2$ test, $p < 0,05$). It is to be concluded that the teachers who participated in the research really do think that implementing neo-managerial approach greatly affects and changes the perception of higher education.[27]

[27] Based on statistical analysis, it is to be concluded that the hypothesis that neo-managerial approach is more frequently applied in the higher education system (H1) is not clearly confirmed by the teachers, as opposed to students who think the opposite. According to the percentage of the tested teachers it is visible that the majority (84%) agree only with the first statement that efficiency and effectiveness form the basis for the higher education system quality. On the other hand, to other statements, they, however, do not have a firmly expressed attitude, which is confirmed by statistical tests. When it comes to the tested students, situation is rather different, since they state a clearly expressed attitude to all the questions. Based on the percentage of students who agree with all the statements from this hypothesis, it is to be concluded that the hypothesis about applying neo-managerial approach in the higher education system has been confirmed. After analysing the sub-hypotheses H1a and H1b, the conclusion is that according to what teachers think about the processes of privatisation, commercialisation and agentification, occurring as a direct consequence of applying neo-managerial approach (H1a) is partly confirmed since they express a clear attitude to all statements, apart from the one referring to the claim that the quality of one's education more frequently depends on their financial abilities where statistical tests show even distribution of opinions. Students, on the other hand, have a firm opinion on every claim referring to sub-hypothesis H1 so it can be considered confirmed. Based on the percentage of the subjects

5. CONCLUSION

Is it justified to implement neo (managerial) values into the system of higher education? Is the perception of higher education as public service being changed? This paper is formed on the basic assumption that the perception of higher education as public service has been changed due to neo-managerial approach implementation. Efficiency and effectiveness are the values typical for such an approach and are significant for ensuring higher education quality. It is considered that national policy should not allow extensive interfering into strategically important matters as is higher education system. By implementing the "Bologna Model", we have proved that we are trying to adapt to the European higher education notion. This, however, does not mean that we should recklessly embrace every idea or reform suggested by the European Union, but should first investigate whether or not the proposed model fits into the existing framework characteristic for a particular area. Oftentimes, we are ready to embrace "the unknown" for one purpose only, and that is to fulfil the expectations of others even though being unaware of the possible outcomes. After carefully inspecting the research results, it is to be expected that in the near future J. J. Strossmayer University of Osijek will surely be affected by privatisation and commercialisation processes. Will this reduce the power and quality of knowledge is yet to be seen. While awaiting the processes to take place, one should nevertheless do everything possible to keep the higher education in the public sphere. Finally, the emphasis is to be put on the fact that for higher education system to efficiently function, all the participants relevant in this area must show their strong will and organisational abilities which will then result in proper management of the system. It is in every citizens' best interest that higher education is to be kept in the public domain in order to provide equal opportunities for future generations.

LITERATURE:

1. Agencija za znanost i visoko obrazovanje [Agency for Science and Higher Education]. Retrieved 4.5.2017. from https://www.azvo.hr/images/stories/visoko/BOLOGNA_DECLARATION1.pdf.
2. Babić, Z. (2004). Participacija i ulaganje u obrazovanje u Hrvatskoj [Participation Rates and Investment in Education in Croatia]. In: M. Dalić et al. (ed), *Privredna kretanja i ekonomska politika* (p. 28-53). Zagreb: Ekonomski institut
3. Bahtijarević-Šiber, F. et al. (1991). *Organizacijska teorija [Organisational theory]*. Zagreb: Informator
4. Beck, C., Robert (2003). *Motivacija – teorija i načela [Motivation – Theories and principles]*. Zagreb: Naklada Slap
5. Blažević, R. (2004). *Upravna znanost – kompendij [Administrative Science - compendium]*. Rijeka: Pravni fakultet Sveučilišta u Rijeci
6. Borković, I. (2002). *Upravno pravo, VII. Izmijenjeno i dopunjeno izdanje [Administrative Law, VII. Revised and supplemented edition]*. Zagreb: Narodne novine
7. Buble, M. (2006). *Osnove menadžmenta [The Basis of Management]*. Zagreb: Sinergija nakladništvo d.o.o.
8. Cardona P., Rey C. (2009). *Upravljanje pomoću misija [Management by Missions]*. Zagreb: Zagrebačka škola ekonomije i menadžmenta, MATE d.o.o.
9. Cvitan, O. (2008). *Upravna organizacija [The Administrative Organisation]*, Šibenik: Veleučilište u Šibeniku

agreeing with the statements referring to sub-hypothesis H1b and the results obtained by statistical tests, this sub-hypothesis is firmly confirmed both by the teachers and the students. It is, therefore, to be concluded that both groups think that due to neo-managerial approach there has been a significant change in perceiving higher education as public service. More about the results in: Dujmović, 2014, pp. 236-241; 247-249.

10. Dujmović, J. (2014). Visoko obrazovanje kao javna služba (doctoral dissertations) [Higher Education as Public Service]. Zagreb: [J. Dujmović]
11. Đulabić, V. (2006). Povelje javnih službi: pokušaj podizanja kvalitete javne uprave i jačanja uloge građana [Charters of public services: an attempt to improve the quality of public administration and strengthen the role of citizens]. In: I. Koprić (ed), *Javna uprava – nastavni materijali* (p. 327-343). Zagreb: Društveno veleučilište u Zagrebu
12. Đulabić, V. (2007). Socijalne službe u konceptu službi od općeg interesa [Social Services within the Concept of Services of General Interest]. In: S. Zrinščak (ed), *Revija za socijalnu politiku* (p. 137-162). Zagreb: Pravni fakultet Sveučilišta u Zagrebu
13. Grbac, B. (2010). *Marketinške paradigme [Marketing Paradigms]*, Rijeka: Ekonomski fakultet Sveučilišta u Rijeci
14. Higher education policies – financing. Retrieved 4.5. 2017. from http://www.iro.hr/hr/politike-visokog-obrazovanja/financiranje-/.
15. Koprić, I. (2003). *Modernizacija hrvatske uprave [Modernisation of the Croatian Public Administration]*, Zagreb: Društveno veleučilište u Zagrebu
16. Koprić, I. (2006). Upravna organizacija [Public Administration]. In: I. Koprić (ed), *Javna uprava – nastavni materijali* (pp. 47-98). Zagreb: Društveno veleučilište u Zagrebu
17. Koprić, I. et al. (2014). *Upravna znanost – javna uprava u suvremenom europskom kontekstu [Administrative Science – Public Administration in Contemporary European Context]*, Zagreb: Pravni fakultet Sveučilišta u Zagrebu
18. Lozina, D., Klarić, M., (2003). *Nova javna uprava [New Public Administration]*, Split: DES.
19. MacCarthaigh M. (2008), Public Service Values, CPMR Discussion Paper 39. Retrieved 6.5.2017. from http://www.cpmr.gov.ie/Documents/Public%20Service%20Values.pdf.
20. Perko – Šeparović, I. (1975). *Teorije organizacije [Organisation Theories]*, Zagreb: Školska knjiga
21. Pusić, E. (1974). *Razvedenost i povezanost [Separation and Reconnection], Encyclopaedia moderna*, Zagreb: JAZU
22. Pusić, E. (1997). *Hrvatska središnja državna uprava i usporedni upravni sustavi [Croatian central state administration and comparative administrative systems]*, Zagreb: Školska knjiga
23. Pusić, E. (2002). *Nauka o upravi [Administrative Science]*, Zagreb: Školska knjiga
24. Tudor, G., Srića, V. (1996). *Menedžer i pobjednički tim – čarolija timskog rada [The Manager and the Winning Team – Magic of Teamwork]*, Zagreb: MEP Consult & CROMAN
25. Ustav RH [Constitution of the Republic of Croatia] (NN 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14
26. Vila, A. (1983). *Teorija i praksa funkcioniranja organizacije [Theoretical and practical functioning of an organisation*], Zagreb: Informator
27. Zakon o državnim službenicima [Act on Civil Servants and Civil Service Employees] (NN 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)
28. Zakon o sustavu državne uprave [State Administration System Act] (NN 150/11, 12/13, 93/16 , 104/16)
29. Zakon o znanstvenoj djelatnosti i visokom obrazovanju [Scientific Activity and Higher Education Act] (NN 123/03, 198/03, 105/04, 174/04, 02/07, 46/07, 45/09, 63/11, 94/13, 139/13, 101/14, 60/15)

CROSS-BORDER CONSUMER DISPUTES IN LINE WITH CJEU RULING IN *VEREIN FÜR KONSUMENTENINFORMATION V AMAZON EU SÀRL*

Mirela Zupan
Josip Juraj Strossmayer University of Osijek Faculty of Law, Croatia
mzupan@pravos.hr

ABSTRACT

Recent cross-border consumer dispute brought before CJEU opened to discussion a number of interesting issues. Main aspects of Verein für Konsumenteninformation v Amazon EU Sàrl of 28 July 2016 ruling relate to applicable law rules to be applied to online sales contacts concluded with consumers resident in other Member States. In the case brought before the CJEU in Luxembourg consumers resident in Austria challenged the operating mechanism of the Amazon EU. Amazon EU is a company established in Luxembourg, with no registered office or establishment in Austria. Amazon EU is offering online sales to Austrians under the domain name with the extension .de. General terms and conditions of such sales contracts contain a choice-of-law clause in favour of application of the law of the Member State in which the company was established. CJEU had to set which law is to be applied for determination of the applicable law for assessing the unfairness of terms in those general terms and conditions in an action for an injunction. CJEU therefore had to delimitate between the substantive scope of application of the 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). Moreover, a claim in regards the processing of personal data of consumers and relevant applicable law was posted, in relation to application of the Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995. This paper would tackle upon academic and practical aspects of the CJEU resolution to this case.

Keywords*: applicable law, consumer, online sales contract, data protection*

1. INTRODUCTION

Development of modern technologies and internet facilities have placed e-commerce to a forefront of European (and worldwide) trade activities. Such a course of development minimizes traditional notions of geographical bond between a seller and a buyer. Moreover, a place where shop is actually situated (or operated by) may be in any EU Member State or outside of EU, while buyer is most often completely not aware of it. Such fact remains un notices at least as long as some aspect of a contract, or a related matter, is not disputed. For the later situation, legal considerations appear (Coteanu, 2017, chapter 1). Most frequently matters would relate to a law governing a contract, particularly what law will ultimately apply to the individual contracts with consumers from different countries. Retailers are intending to conduct sales with domestic and international customers using one single website and using the same general terms and conditions. If the contracted general terms and conditions have been drafted in accordance to the law of the seller, they may not comply fully with the consumer protection rules of the various countries of delivery. Despite comprehensive consumer protection legislation within EU, particularly as of entry into force of *Directive 2011/83/EC on Consumer Rights in June 2014*, no full harmonisation is accomplished yet (Beaumont, McEleavy, 2011, p. 530). Most prominent example is with the rules on warranty rights and damages. *Directive 99/44/EC on certain aspects of the sale of*

consumer goods and associated guarantees obliges a trader in EU to remedy any defect on the sold goods that appeared within 2 years of purchase. It is a minimum level protection standard afforded by EU, but supplemented with national consumer law of a particular member state which may provide higher level of consumer protection (Twigg – Flesner, 2017, chapter 7). Digital internal market placed additional challenges to states as it raises the issue on the powers of public institutions to protect consumers within their territorial borders. Therefore, other disputed issues related to electronic consumer contract in question may be triggered. Legal disputes concerning mega internet sale or service providers have become a modest reality. Case *C 191/15 of Verein für Konsumenteninformation v Amazon EU Sàrl of 28 July 2016* follows the sequence of this practice. Case has been brought before the Court of Justice of the European Union (hereinafter CJEU) by an Austrian consumer protection association Verein für Konsumenteninformation. They challenged the practice conducted by Amazon, a giant internet sales provider, in its course of offering goods to Austrian consumers. Main considerations rest on issues of private international law in relation to consumer contract. Precisely CJEU dealt with applicable law to injunction of a consumer protection association against unfair terms, applicable law for general terms and conditions and applicable law to associated data protection issues.
Case C 191/15 would be scrutinized here having in mind previous CJEU related practice, as well as doctrinal findings. Paper would first highlight the main factual issues in relation to the case C 191/15 (2); legal issues on referring questions with several subchapters on previous related CJEU rulings (3), conclusions on the impact of this order to electronic digital market, particularly in the context of recently adopted General Data Protection Regulation (4).

2. CASE C 191/15 OF VEREIN FÜR KONSUMENTENINFORMATION V AMAZON EU SÀRL

2.1. Facts of a case

Plaintiff to this case is a Verein für Konsumenteninformation (hereinafter VKI), Austrian consumer protection association, whereas the defendant is Amazon EU SARL (hereinafter Amazon EU). Amazon EU is a top European online seller whose business is based in Luxembourg. Amazon EU is serving consumers in all of the EU member states, whereas it holds websites which specifically address consumers of respected member states on their language and with an associated internet domain (www.amazon.fr; www.amazon.de; www.amazon.co.uk). Sales conducted through any of these websites are actually contracted with Amazon EU and are subject to standard terms and conditions that contain applicable law clause in favour of Luxembourg law. In the case at hand Austrian consumers were not granted a separate Austrian domain website, neither the Amazon had any registered office or establishment in Austria. Austrian consumers therefore used the German language website with de. domain. Contacts concluded over any of these web sites utilized standard terms with a provision that Luxembourg law applies. Moreover, these standard terms and conditions indicated that personal data supplied by the consumers in event of purchase and reviews might be exchanged with credit-risk assessment and financial services companies in Germany and Switzerland. From a substantive law perspective, Austrian law provided higher protection for the consumer than the equivalent Luxembourgish law. VKI sought an injunction against Amazon EU, aiming at prohibiting the use of these terms as they found them being contrary to *Directive 93/13/EEC on Unfair Consumer Terms*, as wall to accepted principles of morality. Pursuant to *Council Directive 2009/22/EC on injunctions for the protection of consumers' interests*, such association was qualified entity to obtain orders prohibiting infringements of consumer protection measures. Amazon countered that it has no legal connection with Austria as it has no establishment there. Austrian courts of first and

second instance did not reach a solution, whereas the Austrian Supreme Court addressed the CJEU with several questions.

3-.DISPUTED LEGAL CONSIDERATIONS

3.1. Law applicable to injunction

One of the primary concerns of Austrian Supreme Court was of the characterization. Austrian court questioned if a contractual or non-contractual qualification should be employed to an injunction pleaded against use of general terms by a web shop established in one member state but conducting electronic commerce and entering into consumer contracts with consumers residing in another member states. Moreover, Austrian court wondered where the damage might said to have taken place, if a non-contractual characterization would have been employed. There are two European legal sources to a matter: *Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations* (hereinafter 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* (hereinafter Rome II). Austrian court seeks to know how the regulations Rome I and Rome II should be interpreted for the purpose of determining the law applicable to injunction within the meaning of Directive 2009/22.

CJEU reminded that these regulations should be interpreted consistently with one another, as well as with the Regulation 1215/2012 (prior 44/2001)(hereinafter Brussels I Regulation) (para 36). Some aspect of this preliminary ruling request were previously settled within C-167/00 Henkel case. There was a national case similar factual situation settled before German courts. Namely, German Bundesgerichtshof (hereinafter BGH) faced this matter in 2009 when an action was brought by a registered association under the provision of § 4 Unterlassungsklagengesetz (Injunctive Relief Act) (Study on the application, 2011, p. 77). They were seeking for an injunction to prevent an airline established in Latvia from using a certain clause in its general terms and conditions towards consumers. At case at hand the question of jurisdiction and applicable law appeared alike. Jurisdiction of German courts was based on Article 5/3 of the Brussels I Regulation (No. 44/2001), since the use of unfair general terms of conditions constituted a “harmful event” in terms of that provision. The same qualification was employed by that court to the matter of applicable law. Hence, German court had no doubt if Rome II regulation should to be applied to an action to restrain the use of unfair terms in consumer contracts (decision no. XaZR 19/8 of 9 July 2009, reported by Gaertner, 2010). This very same standing was affirmed by the CJEU in VKI v Amazon. Having in mind its previous Brussels convention and 44/2001 practice, CJEU here argued for application of non-contractual qualification in relation to an injunction, meaning that Rome II had to be applied.

Further dilemma shared by both BGH and CJEU (here in Amazon) was weather provision of Article 4/3 or Article 6 of Rome II regulation is relevant. BGH has skilfully avoided to provide response on the question. It reads carefully the default rule for non-contractual obligation arising out of a tort/delict designating the application of the »law of the country in which the damage occurs irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country in which the indirect consequences of that event occur«, ie. Article 4/1. Bundesgrichtshof applies this provision to a case at hand, arguing that the country in which the damage occurs or is likely to occur is the country where the unfair general terms were used or are likely to be used, therefore the country in which the consumers’ protected collective interests were affected or are likely to be affected. BGH then utilises the provision of Article 6 to support this interpretation, referring thus to Article 6/1 Rome II regulation. BGH used this manoeuvre to avoid answering which of the two

provisions is actually applied to that factual situation. Gap that has been left by the BGH was now filled by the CJEU VKI v Amazon ruling. CJEU here concluded that pursuant to Article 6/1 of the Rome II, the law applicable to a non-contractual obligation arising out of an act of unfair competition shall be the law of the country where the interests of consumers are, or are likely to be, affected. Article 6/1 hence let to application of Austrian law as a law where consumer's interest are affected (Dickinson, 2010, p. 61-69). Additional doubts arose before Austrian courts in relation to application of the Rome II regulation. The escape clause of Article 4/3 of the Rome II regulation empowers a court to employ the closest connection test in order to departure from the designated law. Escape clause is for exceptional situations, only if it is clear that the tort is manifestly more closely connected to another law, which then applies (Calster, 2016, p. 255-256). Austrian courts doubted whether this exception relates to unfair competition of Article 6 as well. CJEU rejects the option of application of escape clause to Article 6, arguing that protection of collective interests enshrined by Article 6 cannot be displaced by individual agreement (para 45). If a contractual term is used to fill the shape of closer connection test, parties are able to avoid the conditions for 'freedom of choice' set down in Article 14 Rome II. This standing is a confirmation of Opinion of Advocate General Saugmandsgaard Øe (para 77).

3.2. Applicable law and Unfair Terms in Consumer Contracts

Further point discussed in the context of VKI v Amazon relates to applicable law in the context of Unfair Contracts Directive. Directive advocates a principle that a contractual term which is drafted in advance by the seller/supplier, in other words that it has not been individually negotiated, must be regarded as unfair if it causes a significant imbalance to the detriment of the consumer. There are notably diverging opinions on characterization of this issue. Advocate General Saugmandsgaard Øe is arguing that actual and existing contract is a prerequisite for contractual qualification. Since there is no such contract in VKI v Amazon, he has rejected contractual characterization here. Advocate General Saugmandsgaard Øe opinion is founded on exact wording of Rome I, which particularly in relevant Article 6/1 addresses contracts already concluded. CJEU however leans on argumentation that law applicable to an assessment of a specific contractual term belongs to contractual qualification (para 58). It meant that Rome I regulation should have been applied, regardless of a fact weather individual or collection action is at stake (Müller 2016, p. 216). CJEU acknowledges that in general consumer contract terms can stipulate towards the law of the member state of the suppliers establishment as a governing law. Still, such terms are unfair if they led the consumer into believing that only the law of that member state applied to the contract. CJEU held that Amazon's standard terms of business were unfair under the Unfair Terms in Consumer Contracts Directive because it gave consumers the impression that only that law would apply. This ruling sends a signal to firms conducting on-line electronic activities towards consumers using standard terms and conditions. Namely, if such standard terms contain governing law clause, consumers throughout EU that would submit to such contract would not be subject to local law of their residence. Such terms of contract might, in the light of a CJEU ruling in Amazon, be unfair. In overall there is a risk of cease-and-desist letters, which would be sent by consumer protection associations and competitors (Braswell, 2007, p. 1241). To avoid such risk, these clauses ought to clearly inform that despite applicable law provision consumers are afforded protection of mandatory provisions in force in the country of consumer's residence. Wording should be in plain and intelligible language, what is again subject to interpretation (McKendrick 2014, p. 464). Here the CJEU departed from Opinion of AG Saugmandsgaard Øe (para 104) as well as its previously established case Aziz test. CJEU introduced a new test to assess the fairness of the choice-oflaw term under the Directive on unfair

contract terms, which, in terms of active/passive consumers, may not be always for the benefit of the later (Rutgers, 2017, p. 175).

3.3. E-commerce and data protection applicable law

Disputes concerning data protection in the course of actions of internet giants, such as Google or Facebook, occupied recently the CJEU as well as interested academic and overall public. Pure data protection issues (particularly who is a data processor?) appear mainly in relation to Facebook activities (Schwend, 2016, p. 141 ff). There are however many interesting conflict of laws issues of data protection that appear in overall context (Brkan, 2016, p. 325-326). Several ground-breaking decisions shape the state of art. Matter has been touched upon by the CJEU in series of rulings focusing to cross-border data protection effects in relation to *Directive 95/46/EC of the European Parliament and of the Council of October 24, 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data* (hereinafter Data Protection Directive 95/46/EC). Issue has been first disclosed by CJEU in Google Spain SL and Google Inc. v Agencia Española de Protección de Datos (AEPD) and Mario Costeja González (C-131/12). Subsequently the topic has been elaborated by the CJEU in a case C 230/14 Weltimmo s.r.o. v Nemzeti Adatvédelmi és Információszabadság Hatóság presented to CJEU by Hungarian Kúria. VKI v Amazon continues the row. Applicable data protection law issues are a cornerstone of a much awaited ruling of a still pending case C-210/12 Wirtschaftsakademie Schleswig-Holstein GmbH v Unabhängiges Landeszentrum für Datenschutz Schleswig-Holstein, lodged on 14 April 2016 by German Federal Supreme Court in Administrative Matters.

Above mentioned CJEU rulings legal framework relates to disputes in the application of Data protection Directive 95/46/EC. Directive provides that each member state should apply its own data protection legislation to the processing of personal data where data processing is carried out in the context of the activities of an establishment of the data controller in the territory of the member state.

3.3.1. Google Spain of 2014

Google Spain SL and Google Inc. v Agencia Española de Protección de Datos (AEPD) and Mario Costeja González (C-131/12) ruling delivered in May 2014 presents a landmark CJEU decision in relation to cross-border personal data protection. Facts of a case speak of a situation in which an announcement for a forced sale of properties arising from social security debts appeared in a Spanish newspaper La Vangurdia. Since Spanish Ministry of Labour and Social Affairs wanted to attract as many bidders as possible announcement was published twice in printed version and later in online version on the web. Newspaper announcement contained also the name of the owner of a property. One of them was Mario Costeja González, who contacted newspaper with a request that personal data are removed from that online version of La Vangurdia. Ground of his complain was that every entry of his name to search machine displayed that announcement, being outdated (old 1 year) and not relevant any more. La Vangurdia claimed that order for that announcement was payed and there is no possibility to delete it as it was validly contracted. Seeking for removal of his personal data Costeja commenced further actions towards Google Spain and Spanish Agency of Data Protection (AEPD). Request that links to that announcement are removed was forwarded by Google Spain to Google Inc., responsible body situated in California United States. AEPD partially satisfied Costeja's request. Namely, complain against La Vangurdia was rejected but against Google Spain and Google Inc. upheld. The later was ordered to remove the links and make access to the data impossible. Two separate actions were brought against AEPD by Google Spain and Google Inc. Google claimed not to be responsible for search machine, while Google Inc. (responsible one) claimed to be outside the scope of

Directive 95/46/EC. Both complained that search machine was not processing personal data. If such argument would be rejected by the court, they further claimed that either of them could be regarded as a data controller. Data were contained in lawfully published article ordered by Ministry. Number of disputed issues reached CJEU. Most relevant for this scientific study are two issues in domain of scope of application of the Data Protection Directive: territorial scope in relation to responsible body outside EU as well as material scope in relation to the issue weather the search engine could be regarded as a data controller.
As for the territorial scope of Data Protection Directive, similar questions appeared before Costeja's application as well. WP 29 Opinion 8/2010 stated that Member State's data protection law is to be applied to data processing "carried out in the context of the activities of an establishment of the controller on the territory of the Member State". (Opinion 8/2010 on applicable law, 2010, p. 11-12). This approach indicated towards very broad scope of application. More detailed explanation was provided by CJEU in Google Spain. CJEU advocated the application of Spanish law to a data processing which was performed by the search engine operated and controlled by Google Inc. Despite the fact that Google Inc. is established in United States, CJEU clarified it was "inextricably linked to" EU established Google Spain. Moreover, performance was carried out "in the context of the activities of", since the advertising activity that is in question here constituted the "means of rendering the search engine at issue economically profitable" (Guidelines, 2014, p. 4.).
Focal point of this ruling is that regardless of the fact that EU establishment has no direct involvement to data processing, activities of such local establishment might trigger the application of EU data protection laws to a data processing controller outside EU. Such effect is reached if there is an "inextricable link" between the local establishment and proceeding activities of a non local establishment. CJEU introduced the notion of "inextricable link" in order to reach a result that Google Spain entity was a relevant "establishment". This standing resulted with application of Spanish data protection laws, leading to an overall result that European regulations should apply as of the moment the data processing benefits the activity of a European establishment. Outcome of this ruling for a foreign company is not in direct extraterritorial application of EU data protection rules (Brkan, 2016, p. 326). However, if a multinational company takes the risk of processing data outside EU, for the benefit of the activity of an establishment located in the EU, it exposes this establishment in accordance with European data protection law.

3.3.2. Weltimmo of 2015

Similar and related aspects of consumer cross-border trade occurred within the case C 230/14 Weltimmo s.r.o. v Nemzeti Adatvédelmi és Információszabadság Hatóság, presented to CJEU by Hungarian Kúria. Facts of case follow speak of a company Weltimmo registered in Slovakia but hosting a website which is directing its services towards Hungarian clients. Weltimmo was runing a website for advertising sale of property in Hungary. In course of that bussines Weltimmo was processing the personal data of the advertisement service users. Number of advertisers have requested a deletion of their verisments as well as their personal data. However, Weltimmo did not delete either. Weltimmo issues a bill to such advertisers for its services, which were not pid. Hence, Weltimmo made a list of debtors and sent names and personal data of detors to debt collection agency. Hungarian data protection office recieved a complain of those advertisers and fined Weltimmo with 10 million Hungarian Forints (€32,000). Weltimmo claimed that Hungarian supervisor had no jurisdiction. Hungarian office still argued that it is indisputable that it holds jurisdiction pursuant to Article 28 of the relevant Directive. The case was problematic in terms of applicable law as well. Namely, application of Article 4/1 of Data Protection Directive »(a) the processing is carried out in the context of the activities of an establishment of the controller on the territory

of the Member State; when the same controller is established on the territory of several Member States, he must take the necessary measures to ensure that each of these establishments complies with the obligations laid down by the national law applicable….« required an answer where Weltimmo is established. The CJEU is hence faced with two main issues: to ascertain if Weltimmo had an establishment on the territory of Hungary, and if the data was processed in the context of the activities of that establishment.

Advocate-General Pedro Cruz Villalón advocated the approach that an establishment is essentially a question of fact. One may disclose where the establishment is by merely looking at where physical activity occurs. Advocate-General Pedro Cruz Villalón states that establishment may be effected by the presence of a single person working from a laptop, so long as that person has the necessary permanence within the Member State. Other factors may be taken into account (egz. where data was entered, the member state at which the services are directed, the nationality/residence of data subject/owner of undertakings), though their relevance is of minor weight (Opinion of Advocate-General Pedro Cruz Villalón, para 20-42).

CJEU followed the Advocate-General Pedro Cruz Villalón Opinion to conclude that the notion of "establishment" is a very broad and flexible concept. Test established by the CJEU consist of positive indicators which must be cumulated in one member state. The state where data controller is registered is not a sufficient indicator. Neither can one claim that an establishment exist in a Member State merely because the undertaking's website is accessible there. Undertaking does not need to have a branch or establishment in that member state either. Degree of stability of the arrangements and the effective exercise of activities in that other Member State must be established. Particularly as for undertakings offering services exclusively over the Internet these factors must be interpreted in the light of the specific nature of the economic activities and the provision of services concerned (para 29). CJEU further argued that even a minimal real and effective activity which is exercised through stable arrangements may be sufficient. Hence, depending on the circumstances, the presence of even one representative can suffice. These indicators applied at Weltimmo smoothly let do conclusion that Weltimmo was established in Hungary (representative, bank account and contact details pointed to Hungary).

Second question for the CJEU was weather the data was processed in the context of the activities of that establishment. Court referred to its reasoning in *Google Spain.* Therefore, processing is not required to be "done by" the establishment, but "done in the context of" activities carried out through that establishment. CJEU selected amongst the indicators offered by Advocate General. Focus of the analogy is with the indicators relevant for data controller, whereas indicators relevant for data subject is, as CJEU argues, completely irrelevant here. CJEU confirmed that the concept of "establishment" of the Directive is to extend to any "real and effective activity, even a minimal one, exercised through stable arrangements". This criteria set out by the Court should have application in any concrete case. Ruling in Weltimmo further broadened the interpretation of "establishment" (D Cole, 2016, p. 378).

3.3.3. VKI v Amazon of 2016

In VKI v Amazon the Austrian courts had to decide if the personal data processing occurred within activities of an establishment situated in a member state other than Luxembourg. Essentially, the question was whether Amazon was established in Austria. CJEU repeated the indicators established with the findings of *Weltimmo* judgment. However, it is notable that Advocate General Saugmandsgaard Øe introduced significant changes to the reasoning in Google Spain. He has suggested a "dual role" of Article 4, having in mind the diverse nature of the territorial scope queried under Google Spain (outer territorial limit) to the ones in VKI

v Amazon (intra EU territorial issue) (para 110, 124). The ratio of reasoning in Google Spain is application of EU rules to external processors. AG Saugmandsgaard Øe departed of the notion of "establishment" created by CJEU in Weltimmo, suggesting a more stringent notion. However, CJEU grounded its decision clearly on Weltimmo ruling. CJEU therefore left a dilemma: does it disagree with a distinction created by AG Saugmandsgaard Øe or he just hasn't ruled it out? (Woods, 2016).

4. CONSUMERS AND BUSINESS IN VIRTUAL WORLD – SOME LESSONS FOR THE FUTURE?

VKI v Amazon decision provides answers to several separate issues. Firstly, in relation to applicable law to an injunction initiated via class action by consumer protection association CJEU for application of non-contractual qualification. In terms of applicable Rome II regulation Article 6/1 hence let to application of Austrian law as a law where consumer's interest are affected. Secondly, in relation to applicable law regarding fairness a contractual term which is drafted in advance by the seller/supplier (and not individually negotiated), CJEU leans on argumentation that law applicable to an assessment of a specific contractual term belongs to contractual qualification. It hence let to application of Article 6/1 of Rome I regulation. CJEU held that Amazon's standard terms of business were unfair under the Unfair Terms in Consumer Contracts Directive because it gave consumers the impression that only that law would apply. This ruling sends a clear message to global companies using standard terms and conditions and a governing law clause which they unilaterally impose, and apply across multiple EU jurisdictions. Such clauses need to be drafted in a manner to clearly inform the consumer that despite chosen law they have the benefit of the mandatory consumer protections in their country of residence.

As for the data processing aspect of the judgment, we must recourse to the previous CJEU decisions. Google Spain and Weltimmo seriously reduced the margin of manoeuvre for multinationals willing to designate a single data controller for all their EU data processing activities. CJEU clarified that a supervisor of one Member State's could hold jurisdiction over organizations that are established outside the border of that State. Concept of "establishment" extends to any "real and effective activity, even a minimal one, exercised through stable arrangements". Court also held that the processing of personal data need not to be actually carried out by that establishment, it merely has to be "in the context of activities" performed by that establishment. Ruling of Weltimmo set a broad concept with a low threshold for determining whether a data controller is "established" in a particular Member State. The Weltimmo judgement is only affirmed by Amazon. It is for the Austrian national referring court to decide if Amazon have engaged with data processing in the course of activities of the establishment situated outside Luxembourg. CJEU reiterates that when considering whether a data processing operation is established in a Member State, both the degree of stability of the arrangements as well as the effective exercise of activities in the Member State in question must be assessed.

Due to increasing global search machines, social networks and e-commerce the data protection of European citizens engaged in any of these becomes of high relevance. EU has initiated a reform on data protection rules in 2016. Reported figures indicate extremely low level of trust in online companies as well as high concern for misuse of personal data. Less than a quarter of Europeans trust online businesses like search engines to protect their personal data, while on the other hand two thirds of respondents dislike the lack of complete control over their personal data (Special Eurobarometer - Data Protection, 2015, p. 24). Newly adopted *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* (hereinafter: General Data Protection Regulation

/ GDPR), which would produce full effects on 25 May 2018. GDPR added new legal framework for data controller and data processor relationship as well (Škrinjar Vidović, 2016, p. 176 ff). As for the personal data protection, the GDPR would significantly improve its protection. Unlike the Data Protection Directive rule on application of national law, from June 2018 al processing of personal data in the context of the activities of an establishment of a controller or a processor in the Union would be carried out in accordance with EU rules, regardless of whether the processing itself takes place within the Union.

Newly adopted legal framework clarifies that establishment implies the effective and real exercise of activity through stable arrangements. The legal form of such arrangements, whether through a branch or a subsidiary with a legal personality, is not the determining factor in that respect (recitals 22-24). The provisions of GDPR follow the findings of here presented relevant CJEU rulings, hence have codified the CJEU criteria of Google Spain and Weltimmo.

LITERATURE:

1. Beaumont, P. McEleavy, P. (2011) *Anton's Private International Law*. W.Green Edinburg.
2. Coteanu, C. (2017) *Cyber Consumer Law and Unfair Trading Practices.* Routledge.
3. Dickinson, A. (2010) T*he Rome II Regulation: The Law Applicable to Non-contractual Obligations.* Oxford University Press.
4. McKendrick, E. (2014) *Contract Law: Text, Cases, and Materials*. Oxford University Press.
5. Twigg – Flesner, C. (2017) *Consumer Product Guarantees.* Routledge.
6. Van Eechoud, M. (2006) The Position of Broadcasters and Other Media under the Proposed EC 'Rome II' Regulation on the Law Applicable to Non-Contractual Obligations. *IRIS plus, No. 2006-10,* Available at SSRN: https://ssrn.com/abstract=973774
7. Braswell, R. (2007) Consumer Gripe Sites, Intellectual Property Law, and the Use of Cease-and-Desist Letters to Chill Protected Speech on the Internet *Fordham Intell. Prop. Media & Ent. L.J. 17* (4), p. 1241–1287.
8. Brkan, M. (2016) Data protection and Conflict of Laws: A Challenging Relationship *EDPL* 3/2016, p. 324-340.
9. Rutgers, J. (2017) Judicial Decisions on Private International Law 1 *NILR*, p. 163-175.
10. Gaertner, V. (2010) *German Judgment on Rome II. http://conflictoflaws.net/2010/german-judgment-on-rome-ii/* 25.4.2017.
11. D Cole M. (2016) "Weltimmo" Reloaded: CJEU Further Clarifies the Concept of "Establishement"*EDPL* 3/2016, p. 377-380.
12. Müller, F.M. (2016) Amazon and Data Protection Law – The end of the Private/Public Divide in EU conflict of laws? *EuCML* 5/2016, p. 215-218.
13. Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011
14. on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the
15. European Parliament and of the Council and repealing Council Directive 85/577/EEC and
16. Directive 97/7/EC of the European Parliament and of the Council, OJ L 304/64, 22.11.2011.
17. 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 *OJ L 171, 7.7.1999, p. 12–16*
18. Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95/29

19. Directive 2009/22/EC on injunctions for the protection of consumers' interests OJ L 110, 1.5.2009, p. 30.
20. Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data OJ L 281, 23.11.1995, p. 31–50
21. 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 (recast) (Brussels I Regulation) OJ L 351, 20.12.2012. p. 1-32.
22. Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations OJ L 177, 4.7.2008, p. 6–16 .
23. 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, p. 40–49, Special edition in Croatian: Chapter 19 Volume 006, p. 73 – 82.
24. 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) (Text with EEA relevance) OJ L 119, 4.5.2016, p. 1–88.
25. Case C-131/12 Google Spain SL and Google Inc. v Agencia Española de Protección de Datos (AEPD) and Mario Costeja González, Grand Chamber of 13 May 2014. ECLI:EU:C:2014:317.
26. Case C-230/14, Weltimmo s. r. o. v Nemzeti Adatvédelmi és Információszabadság Hatóság, 1 October 2015. ECLI:EU:C:2015:639.
27. Case C 191/15 of Verein für Konsumenteninformation v Amazon EU Sàrl of 28 July 2016 ECLI:EU:C:2016:612.
28. Case C-415/11 M. Aziz v. Caixa d'Estalvis de Catalunya, Tarragona/Manresa (Catalunyacaixa) of 14 March 2013, ECLI:EU:C:2013:164.
29. Case C-167/00 Henkel of 1 October 2002, EU:C:2002:555.
30. Opinion of Advocate General Saugmandsgaard Øe in Verein für Konsumenteninformation v Amazon EU Sàrl, delivered on 2 June 2016. Case C-191/15, Request for a preliminary ruling from the Oberster Gerichtshof. ECLI:EU:C:2016:388.
31. Opinion of Advocate General Cruz Villalón delivered on 25 June 2015, Case C-230/14 Weltimmo s.r.o. v Nemzeti Adatvédelmi és Információszabadság Hatóság. ECLI:EU:C:2015:426.
32. Opinion of Advocate General Jääskinen delivered on 25 June 2013 (1)Case C-131/12 Google Spain SL Google Inc. v Agencia Española de Protección de Datos (AEPD)
33. Mario Costeja González. ECLI:EU:C:2013:424.
34. Special Eurobarometer 431 DATA PROTECTION, summary, June 2015. Available at http://ec.europa.eu/commfrontoffice/publicopinion/archives/ebs/ebs_431_sum_en.pdf
35. Study on the application of Directive 2009/22/EC on injunctions for the protection of consumers' interests (former Directive 98/27/EC) Specific Contract N° 17.010403/11/596569 Final Report. (2011) 24.4.2017. http://ec.europa.eu/consumers/enforcement/documents/study_on_injunctions_directive_final_report-18_12_2011_en.pdf
36. Guidelines on the Implementation of the Court of Justice of the European Union Judgment on "Google Spain and Inc V. Agencia Española De Protección De Datos (Aepd) and Mario Costeja González" C-131/12, 26 November 2014 14/EN WP 225, 22.4.2017. http://ec.europa.eu/justice/data-protection/article-29/documentation/opinion-recommendation/files/2014/wp225_en.pdf
37. Opinion 8/2010 on applicable law Article 29 Data Protection Working Party, 16 December 2010, 0836-02/10/EN WP 179 22.4.2017.

http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2010/wp179_en.pdf
38. Woods, L. (2016). *VKI v Amazon, Which data protection and consumer law applies to Amazon?* 24.5.2017. http://eulawanalysis.blogspot.hr/2016/08/which-data-protection-and-consumer-law.html

CONSUMER PROTECTION IN ANCIENT ROME – *LEX IULIA DE ANNONA* AND *EDICTUM DE PRETIIS RERUM VENALIUM* AS PROHIBITIONS OF ABUSE OF DOMINANT POSITION?

Marko Sukacic
Faculty of Law Osijek, Josip Juraj Strossmayer University of Osijek
S. Radića 13, 31 000 Osijek, Croatia
msukacic@pravos.hr

ABSTRACT

This paper deals with the first ancient Roman prohibition of abuse of dominant position and with the consequences of such prohibition on the protection of buyers of groceries. In that sense, these solutions will be compared to the contemporary practice in the EU, especially with regard to Article 102 of the TFEU. The Lex Iulia de Annona *(D. 48,12) prescribed criminal prosecution of persons who had committed any act or transaction by which they jeopardized the prices of provisions and groceries, in a way that they increased. This could be seen as one of the first attempts to prevent behaviours that lead to commercial monopolies. The* Edictum de pretiis rerum venalium*, issued by the emperor Diocletian, was also an effort to protect the consumers in a way that it set maximum prices for goods and services and prescribed criminal penalties for conducts contrary to the ban. Both examples show how certain groups of buyers were indirectly protected from greedy professional traders, who often used morally questionable methods to raise grocery prices. For example, such methods were frauds, forming of associations, detentions of a ship or a sailor or any other act which could result in a delayed delivery of grains and other groceries and ultimately an increase of prices. The sanctions were of criminal nature, and the penalty was a financial one. Even though this matter falls within the scope of competition law, it had, without a doubt, enormous influence on the protection of buyers of everyday items, which were essential for their lives. Bearing this in mind, such buyers will be compared to modern consumers, and the protection offered by ancient Roman law solutions to contemporary consumer protection.*

Keywords: *dominant position, consumer protection, price, Roman law*

1. INTRODUCTION

Commercial monopoly is a phenomenon which human society has encountered many times throughout history. It is a usual by-product of trade and capitalism, and it is natural for the seller to strive to reach it. Besides, every stakeholder on the market is trying to minimalize the competition and increase the profit. If he succeeded in his attentions, he would be the only seller, so the profit would be guaranteed. A similar situation is where he makes unfair deals with the competition to exploit buyers. The substantial problems of such behaviours are the consequences on the market itself and on the quality and prices of products of such sellers. This paper will mostly focus on the second consequence, namely prices. Since such sellers are the only ones on the market or have a certain deal between themselves, they can dictate the prices. This does not have to be perceived as negative, but again, time has shown that in most cases monopolists will not raise the quality of their products, but will increase the prices and ultimately abuse their dominant positions. When it comes to the quality of goods, there is no logical reason to invest in quality because the buyer has no other choice but to trade with such sellers and nothing forces the seller in a dominant position to invest in quality improvement. A similar situation is with the prices; whether the buyers agree with the prices set by the seller or not, they do not have much of a choice. This was an especially sensitive

issue with regard to groceries, because they are products without which it is not possible to live, so it was necessary to keep them at reasonable levels. During the Roman Empire, problems of commercial monopolies existed, since there are many examples of laws aimed at minimizing the negative effects of monopolies with a special emphasis on the protection of buyers of groceries, particularly of wheat. Such buyers can easily be compared to present buyers – consumers, and this legislation will be examined and compared to the modern attempts to solve similar issues. Of course, a certain analogy is necessary, since Roman society was functioning differently from the present, and law and state had different powers and influence on everyday life.

2. ROMAN EMPIRE

2.1. Delivery and prices of grains

Rome, as the centre of the Roman Empire, was a large city, and as such could not produce enough grain for the whole population. There are no exact city population figures, but some authors suggest that it was between 800,000 and 1,000,000 in the period of its greatest development and size. Data shows that the annual consumption of wheat was approximately 390,000 tons, which was enough to feed approximately 2 million people a year. Such data does not mean that Rome's population was that big, because we should take into consideration loss and wastage due to improper storage (Hopkins, 1978, pp. 98-99). That clearly shows why grain merchants emerged and the import of grains took place, since it is highly unlikely that the city could produce enough wheat for its needs. It did not come easy at first, since there were lots of risks in that kind of business, mainly pirates and the uncertainty of sea travel and transport. The problem of pirates was somewhat solved by 76 BC, when the Roman government cleared the Mediterranean Sea of pirates and after that piracy was no longer a threat in the first and second centuries AD (Braund, 1993, pp. 195-204). The second mentioned problem was partly solved with *fenus nauticum*, a type of maritime loan that was the forerunner of the modern insurance contract, which reduced the risk of financial loss in cases of maritime damage (Žiha, 2012, pp. 77-78; Benedict, 1909, p. 241).

When wheat was delivered to the city, the Roman authorities provided distribution of grain to certain residents, which was about one third of the whole consumption (Kessler, Temin, p. 316). Such generosity of the authorities was not due to high moral standards, as it was intended to keep residents calm and content. Historically speaking, the supply of wheat was always the duty of the government. There are several texts written by the Roman historian Titus Livius where he explains that it is the duty of the government to take care of the market of wheat, to make sure it was properly supplied and to sell it to the public at moderate prices (Liv. II, 34). We might say that this kind of behaviour could be viewed as a form of protectionism or state intervention to keep prices at a reasonable level. Such price was called *annona vetus* in Latin, and it could not be raised suddenly and drastically (Smith, 1859, pp. 548-551). In ancient times, this job was conducted by the Roman magistrates called *Curulae Aediles*, whose name is said to be derived from their having the care of the temple of Ceres, the goddess of agriculture, grain crops, fertility and motherly relationships (Divković, 1900, p. 43). As the Roman Empire grew, agriculture in Italy started to decay and the import of wheat from the provinces rose. Combined with the decrease of the free population and the increase of the number of slaves, the government had to pay more attention to the supply of the said goods to the city. Wealthy individuals who strived to gain more popularity and influence, which was best done with donations of wheat, created the whole idea of the government's obligation to give away wheat. Historically, the process of wheat distribution can be divided into three periods; the first started with the legislation of C. Sempronius Gracchus and ended with Caesar's intervention, the second are Caesar's and Augustus's

reforms of and modifications to the practice, and the last is the post-Augustan period, with an emphasis on Diocletian's reforms.

The first step toward the institutionalization of such practice was made in 123 BC, when C. Sempronius Gracchus passed the *Lex Frumentaria*. This legislation stipulated that each citizen was entitled to receive a certain quantity of wheat monthly, at the specially set price of six and one third *asses* for one measure of *modius. Modius* was a Roman dry measure, equal to one third of an amphora (Smith, 1859, pp. 548-551). There are some differences in literature, and we can find another price in Titus Livius' *Periochae*, yet most authors state that the price mentioned above is more likely (Mommsen, 1844, p. 179). Such price was not the market one, since one *modius* of wheat in those times was sold for the price of 12 *asses* (Böckh, 1838, p. 420). Even though the Roman writer Plutarch states that wheat was sold exclusively to poor citizens, Cicero and other authors claim that it was sold on said terms to the entire free population, regardless of wealth (Smith, 1859, pp. 548-551). It is believed that this legal solution was borrowed from Greek city-states, since in those cities regular public distribution of wheat was a normal practice, and authors claim that Gracchus was educated in Greece (Rickman, 1980, p. 156).

The next legal text which deals with this matter is the *Lex Appuleia*, prepared by the demagogue Appuleius Saturninus in 100 BC. This law set the rule that the government would sell wheat at the price of five sixths (5/6) of an *as* for the mentioned *modius*. It is unknown whether such text ever came into force, since the ancient legal source *Rhetorica ad Herennium* states that Quintus Caepio, a city quaestor at that time, tried to explain in front of the Roman Senate that such law would leave the state treasury empty and took drastic measures to stop this proposition from becoming a law (Unknown author/Cicero/Cornificius, *ad Herenn.* I.12). The *Lex Livia*, proposed by the tribune M. Livius Drusus in 91 BC, met identical fate and never came into force. It is not known what the content of this legal text was, but *Periochae* gives us the insight that it concerned the same topic. The *Lex Octavia*, on the other hand, proposed in the same period as the above-mentioned *Lex Livia*, was adopted. Marcus Octavius proposed it, and Cicero claims that he inaugurated a moderate dole; this was both practicable for the state and necessary for the commons. Cicero concluded that this law was a blessing both to the citizens and to the state. (Cicero, *de Off*. II.21, *Brut*. 62,222). All this led the Senate to promulgate the *Lex Terentia Cassia* in 73 BC, which set the rule that each Roman citizen should receive five *modii* a month at the price of six and one third *asses* for each *modius* (Smith, 1859, pp. 548-551). It is found in various Cicero's speeches that almost all provinces were obligated to supply Rome with groceries at fixed prices, while they were paid directly from the state treasury (Cicero, *Verr*. III.70, V.21).

As can be seen above, there were many legal texts in a short period of time, which gave different solutions. Furthermore, most of them have not been preserved, but we rather have small fragments and opinions on them given by writers and historians from that time. This shows that it was a delicate matter with many gaps which were abused by individuals, so new laws were required to "patch" those voids. In addition, public demand rose, and it was a kind of "public interest" to raise the quantities of allotted wheat and to lower the prices. Secondly, since the texts have not been preserved, there is still a lot of open questions, and any specific and exact conclusions on figures are approximate. In any case, it is a fact that the situation was complex, since the state bought the wheat and groceries, and then sold it to the people below market prices. The famous Roman emperor Caesar, during his consulship in 58 BC, before he "de facto" became emperor, changed this practice in a way that citizens no longer had to pay anything at all. The whole idea can be viewed as protection of citizens on the one hand, but on the other it should not be forgotten that this move had a political background and was, in fact, a way to buy voters' sympathies. This was done with the *Lex Clodia*, named after the tribune Clodius (Tatum, 1990, p. 188). Since wheat was distributed without any

payment, it had, without doubt, an enormous negative impact on the state treasury, and it allowed many speculations and frauds. This was somewhat corrected when Caesar became emperor. Of course, he did not try to abolish this practice entirely and for good, because it would mean his demise, but rather tried to make it fairer, and he considered that the best way to do so was to reduce the number of people who received wheat. This we find in the *Historia Romana*, which translated in English means "The History of Rome". It is a piece written by the Roman political leader and historian of Greek origin Cassius Dio. He says that after his triumph Caesar gave the population wheat beyond the regular amount, and even olive oil. Furthermore, he claims that Caesar realized that the number of recipients of wheat rose enormously by unlawful methods, so he conducted an investigation and reduced their number from 320,000 to 150,000 (Dion Cass. XLIII.21). Authors such as Mommsen claim that after that wheat was no longer given away, but again had to be paid, and again the price was a privileged one (Mommsen, 1844, p. 187). Persons who were entitled to free wheat received tickets, called *tesserae nummariae* or *frumentariae*. Such tickets were small tablets marked with numbers, and the person who had them could receive the quantity written on it (Sueton. *Aug*. 40, 42, *Nero*, 11). The situation changed after Caesar's death, since it can be found in the *Monumentum Ancyranum* that his successor Augustus increased the number of recipients of wheat. Like Caesar, Augustus tried to set rules to protect citizens on the one hand, but also to buy their sympathies on the other (Brunt, Moore, 1967, p. 27). There were several problems in this period, and the way to deal with them was making new laws, even though this represented a problem in itself. Some of the problems which occurred in the above-mentioned period were partially solved with the *Lex Iulia de Annona.*

2.2. Lex Iulia de Annona

Shortly after the increase of wheat recipients, Augustus did the opposite and reduced the number of recipients in 2 BC, setting it to 200,000 people. We learn this from his own words, since he says: "in my 13th consulship I gave 60 *denarii* a piece to the plebs who were at that time in receipt of public grain; they comprised a few more than 200 000 persons" (trans. cit. Brunt, Moore, 1967, p. 27). It should be emphasized that the main requirements which recipients had to meet were full Roman citizenship and residence in the city. This was easily checked, since citizens were registered by districts. In 22 BC, the emperor Augustus assumed supervision of the public supply of grain and soon after, in 18 BC, issued a law named *Lex Iulia de Annona.* The Latin word *annona* has several meanings, but in this context it means yearly production of grains and supply for the city of Rome (Divković, 1900, p. 89). In addition, this term denotes a tax, which was paid in kind, or a central authority that was dealing with the collection and redistribution of the aforementioned tax (Jaramaz Reskušić, 2006, p. 308). We do not have the original text of the mentioned law, but rather several fragments in Digest, written by the Roman jurists Marcian and Ulpian (D. 48,12). The first fragment, written by Marcian, states that a slave could file a criminal complaint against his master if he avers that his master has committed fraud, which was in some way connected to provisions belonging to the public (Marc. *Ins. Lib.* 2 in D. 48,12,1). If the master was guilty of such fraud, the penalty was financial, 20 *aures.* These provisions seek attention, since they differ from certain Roman legal standards. Firstly, Roman law sees a slave as a 'thing' that can speak, an object of law without any legal personality, called *res* in Latin, like any other item. The general rule was that a slave could neither be sued nor be a plaintiff in a trial (Berger, 1953, p. 704.). Yet, the 'thing' was allowed to file a complaint against the person, a subject of law. This shows that the matter was delicate, and the information on such fraud was so important that it could be acquired even from an object of law. Secondly, it shows that slaves had such information, and that they probably participated in such frauds, both willingly and by orders of their masters. This is not uncommon, because slaves were carrying

on great businesses for their masters, with their own free hand, borrowing and lending money, and renting lands (Buckland 1912, p. 18). Slaves were sometimes even partners in firms/legal entities of that time, which should not be mistaken for modern, contemporary firms. We find this in a quote of Ulpian, who states that if such slave carries on a banking business, he can do so, even with his own private means. Still, even in this case, his master is liable for his slave's obligations, to the level of the invested (Ulp, *libro 4 ad edictum* in D.2,13,4,3). A second solution, which shows that Roman slaves conducted business and concluded contracts, is *peculium*. It can be translated as "small flock of sheep" (Divković, 1900, p. 763.), which was in ancient times given to the slave to manage it. Later, it was a term that meant an amount of money which the master gave to the slave to conduct business (Berger, 1953, p. 624). It was also the first example of limited liability, since slaves could not be sued; the master was liable, but not beyond the value of the *peculium*.

Ulpian wrote another Digest fragment with parts of the *Lex Iulia de Annona*, where he states that the mentioned law prescribes a penalty against a person who commits any act or forms any association by means of which the price of wheat and grain may be increased (D. 48,12,2). Such association was probably *societas*, a contract of partnership between two or more persons, with the purpose of sharing profit and losses (Berger, 1953, p. 708.). Obviously, such organisations were created with the sole purpose to speculate with prices. He continues by stating that no one shall detain a ship or a sailor, or maliciously commit any act by which delay may be caused (D. 48,12,2, translated by Scott, 1932). The penalty was again financial, 20 *aures*. In addition, there is one fragment in Justinian's *Institutiones* where it is said that the *Lex Iulia de Annona,* which forbids illegal acts for raising the price of wheat, prescribed a special kind of prosecution on people who committed those acts. Such penalty was not a death penalty, but rather less severe, even though it is not specified which one (I. 4,18,11).

All measures taken by Augustus could be summarized in several sentences. First, he realised that the system of free distribution of wheat was good for raising popularity, so he did use it in that sense. However, he did not give it away for free endlessly, but rather tried to set rules to organise the prices of wheat. Second, he also realised that the system had flaws, and that it allowed many individuals to speculate with prices by detention of ships or sailors, or other malicious acts. Since they are mentioned in the Digest, it is obvious that such acts were committed. Third, if someone was caught in such an act, the penalty was not too severe, which is a bit unusual. Typically, Roman criminal law had strict penalties, and this demonstrates that maybe this ban was intended to prevent such behaviours, but not to completely repress them. Forth, this ban was still included in the Digest, which was compiled in 530-555 AD. It might have been included there because of its historical value, but it should not be forgotten that the Digest was applied as any other legal text or law, meaning the ban was as applicable as when it had been first written. It is questionable whether this could mean that such malicious acts were committed in the Byzantine Empire. In addition, all this demonstrates that even though wheat was often distributed free, it was not like that all the time. In those times, when wheat was sold to the public, the final aim of such legislation was the protection of citizens of Rome. The *Lex Iulia de Annona*, like all before it, tried to protect the buyer, the weaker party of the contract, from the seller, who was often a professional merchant with a lot of experience in sales. All those measures strived to help buyers, since they were, without the need for further analysis, the weaker parties of such contracts. This could be compared to modern consumers, who are mostly buyers of goods from professional sellers, who are doing business. In such contracts, the buyer is in a disadvantaged position, since the seller has much more experience in such legal transactions.

Emperors who followed Augustus continued with the tradition of distribution of wheat and with the limitations of maximum prices. They even allowed legal transactions of the right to

wheat, by allowing a free flow of the previously mentioned tickets, the *frumentariae.* We find this in a Digest quote, where Paulus, *On the Lex Julia et Papia*, says that a ticket for wheat, which is left as inheritance to Titius, after his death can be appraised for value and then paid to anyone who is his successor (D. 39,49,1). There were some struggles and problems with wheat distribution in this period, but they were more related to technical problems arising from free distribution, and as such will not be covered in this paper.

2.3. Edictum de Pretiis Rerum Venalium

The *Edictum de Pretiis Rerum Venalium* is an edict or a decree, issued by the emperor Diocletian between 20 November and 10 December of the year 301 AD, which prescribed maximum prices for more than 1,400 products, raw materials, labour and services, transport, animals and slaves (Kropff, 2016, p. 1). Translated into English, this edict could be called "The Edict on Maximum Prices". The whole text of this edict has not been preserved completely in its original form; yet there is plenty of epigraphic evidence, found mainly in the eastern parts of the former Roman Empire, that has resulted in several reconstructions, which are probably correct. The whole document was divided into two parts; the introduction, or in Latin *praefatio,* naming the reasons for this act, and the second part as an index of maximum prices of products. The original title of this edict is not known, and the title *Edictum de Pretiis Rerum Venalium* comes from Lactantius's work *De Mortibus Persecutorum,* which translated into English means "On the Deaths of the Persecutors". There Lactantius criticizes Diocletian, stating that he attempted to limit the prices of goods. He continues that death penalties were a common sanction for the smallest breaches, stating that a lot of blood was shed. This scared the population and people were afraid to sell anything. He concludes that, after it proved a bad measure, it was from mere necessity abrogated (Lactantius, *De Mortibus Persecutorum,* VII, 3.3.). This should not be taken completely as truth without scepticism, since Lactantius was a Christian author and Diocletian was a persecutor of Christians. Besides, Lactantius's work is called "On the Deaths of the Persecutors", and he describes Diocletian as the author of ill, deviser of misery and the person who was ruining all things which he put his hands on (Lactantius, *De Mortibus Persecutorum,* VII, 1). It is obvious that this description of Diocletian and his reforms has a strong political and ideological background. In any case, we can agree with Lactantius on one thing, and it is that this kind of measure is clearly ineffective as a means to stop inflation and to protect citizens, but it demonstrates that the problem of prices of wheat and groceries was present and recognized, and that something had to be done in that sense.

There is also one technical problem in the edict, in its *praefatio,* where it is said that the maximum prices are effective in "*totius orbis nostril*", i.e. in "our whole realm". That means in both the western and eastern parts of the Empire, under Diocletian and Maximianus. It should not be forgotten that Diocletian himself divided the Empire and set the rules for the succession of future rulers. Yet, evidence of its existence is found only in eastern parts, so it is highly questionable whether this edict was also applicable in the west (Kropff, 2016, p. 1). Regarding the motivations for such act, it is stated in the *praefatio* that some people are always eager to turn profit, and that they destroy general prosperity. In addition, such persons are wealthy and rich, and still use bad harvests to negotiate high prices for themselves. It is said that such persons are so rich that with their money the whole nation could be satisfied, but they are still greedy and want more (Kropff, 2016, p. 9). Furthermore, set prices were obligatory for both sellers and buyers who went to ports and visited foreign provinces, and in such way prevented persons who were engaged in transport of goods to sell said items somewhere else outside the city for higher prices. An interesting part is a reminder where Diocletian states that the ancestors before him also did similar with legislation. This shows us that he is aware of the legislation mentioned above and is continuing in the same direction.

Diocletian says it is his humanity which urges him to set limit. In other words, he is willing to put public interest in front of free trade. A similar situation is present today, where competition law creates barriers for fully free trade in order to give protection to consumers, which is again viewed as public interest.

The first item in the index, the second part of the edict, is wheat, and its price is set at 100 *denarii* for one *kastrensis modius*. One *kastrensis modius* is Roman double bushel, which is approximately 17.51 litres in volume (Kropff, 2016, pp. 5-10). Regarding the prices, all are displayed in *denarii*.

The prices of other items vary between two *denarii*, which the pool attendant in the baths could demand from the user of baths, to the enormous 150,000 *denarii* for a male lion. Authors state that these prices are a bit above the regular ones, which is logical, since the idea of this edict was to set maximum prices, and not the minimum ones (Ermatinger, 1996, pp. 86-112). It should be emphasized that it is not by chance that wheat takes the first place in the index. After all, it is the most important item to most buyers, and it is logical to put it in the first place.

When we try to analyse all said, we can conclude that these measures were created to stop one group of sellers and merchants from exploiting the fact that buyers had to buy certain items from them. They were professionals, who dictated the prices and had monopolies and dominant positions on the market. They were aware of it and abused it so much that Diocletian had to intervene. Of course, this was not the first time, since there were plenty of laws before him, which he mentions in the *praefatio*. History has shown that limitation of prices was an extremely inefficient means to protect consumers from unfair treatment by merchants. In addition, it should be noted that price raising was not purely caused by abuse of dominant position by merchants, but also by the political and economic problems of that period, especially because of the return to natural economy, caused by a military and political crisis (Hekster, Zair, 2008, pp. 35-36). Under such conditions, it is not possible to maximise prices and hope that would solve all the problems. Luckily, there were other reforms than Diocletian's, so the situation improved for most of the population, but those reforms were oriented to other branches of law, and as such will not be covered in this paper.

3. CONTEMPORARY SOULUTIONS

3.1. EU level

The European Union (hereinafter referred to as "EU"), as a political and economic union of 28 member states, has created an autonomous legal system in which freedom of movement of people, goods, services and capital between all states is guaranteed. Consumer protection was not in the focus of the EU in its beginnings, but as it grew, so did the Union competences and its goals. Some of the goals of this, often called "*sui iuris*" organisation are in the Charter of Fundamental Rights of the European Union, such as human dignity, freedom, democracy, equality, the rule of law and respect for human rights. In addition to those, an important aim of the EU for this topic is referred to under Art. 38. of the Charter, which states that Union policies shall ensure a high level of consumer protection. This gives the Union another argument to intervene to give more protection to consumers. The topic of abuse of dominant position is, however, in the area of competition law, which has some other goals. Yet, it would be inappropriate and incorrect to claim that these two branches of law are not connected. On the contrary, events in the area of competition law influence consumers greatly, and vice versa. In this manner, this chapter will refer to some of the competition law solutions which strongly affect consumers.

Article 102 of the Treaty on the Functioning of the European Union (hereinafter referred to as "TFEU") aims to prohibit abusive conduct of companies that have a dominant position on the market. This article states that any abuse of dominant position, made by one or more

undertakings within the internal market shall be prohibited as incompatible with the market, in case it may affect trade between Member States. This means that one or more subjects could be in a dominant position, so not necessarily just one, as it is commonly assumed. It should be pointed out that it is not forbidden to have a dominant position, as long as it is not abused. A dominant undertaking, which holds such market power, could have the ability to set prices above the competitive level, and could even sell products of an inferior quality for higher prices. In addition, it is required that such dominance is interfering the internal market between two or more Member States, so this article does not cover cases of national dominance.

Moreover, it continues by giving examples of such abuse, and there is an example where an undertaking is directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions. This is pretty similar and comparable to the above-mentioned Roman solutions. In both examples, a certain kind of authority tries to specify rules to prevent unfair selling prices of particular items, which are set by the seller who has the dominant position. Even though this article is applicable to prices for both consumers and professional traders/buyers, for the purpose of this paper the focus is on the protection of consumers in such cases.

One of such cases was the famous *United Brands* case (Case 27/76 - Judgment of the Court of 14 February 1978. - United Brands Company and United Brands Continentaal BV v Commission of the European Communities - Chiquita Bananas) from 1978. It deals with an abuse of dominant position by United Brands Company, the importer of the Chiquita brand of Latin American bananas to various Member States of the European Community (the current EU). The distributors were buying them while still green, ripening them using their own facilities and distributing them to retailers across their national markets. This company had a dominant position in respect of its trade and supply with distributors. The European Commission, the body that was competent for investigating such matters, established that United Brands was charging unfairly high prices to customers in certain member states. When this case reached the Court of Justice, it decided that charging a price which was excessive because it had no reasonable relation to the economic value of the product supplied might be an abuse of a dominant position. However, the Court stated that the burden of proof that such prices were exploitative of consumers was on the Commission, and in this case the Commission did not prove that the prices were abusive (Case 27/76). This is an old case, but still a meaningful one. Some authors state that the contemporary EU solution is still not flawless, and that the problem is in the lack of clarity and legal certainty regarding the abuse of excessive pricing (Akman, Garrod, 2011, p. 19). This supports the thesis that the struggle to resolve the issue of protecting consumers in such situations is still present.

3.2. Croatian legislation

The Croatian legislation also forbids abuse of dominant position, and such ban can be found in Art. 13. of the Croatian Competition Act (Zakon o zaštiti tržišnog natjecanja), which says that the abuse of dominant position is forbidden. Like the TFEU, it gives several examples of such practice, and in the first place is direct or indirect imposition of unfair prices. This also demonstrates that the Croatian solution was deeply influenced by EU law, which is not surprising, since Croatia is a Member State of the EU and has adapted its law to the *acquis communautaire.* A significant difference is that this solution is applicable to national dominances, since it is in the national law and it regulates national, domicile situations. If there is a case involving the abuse of a dominant position, it is in the competence of the Croatian Competition Agency (Agencija za zaštitu tržišnog natjecanja), which declares that such abuse happened and prescribes adequate sanctions for it. One such case is Croatian Competition Agency vs Crafts Chamber of Osijek-Baranja County, Association of Craftsmen

Osijek, Baker Section and Seventeen Entrepreneurs who attended the meeting on 16 February 2011. (Rješenje Agencije za zaštitu tržišnog natjecanja). At this meeting, the mentioned bakers discussed the price of bread and the necessity to raise it and agreed on the orientation price of eight Croatian kuna for white bread. In addition, it is necessary to point out that even though they held the meeting, they did not increase the price of bread. The Crafts Chamber of Osijek-Baranja County was the initiator of this meeting, which is why it was fined along with the bakers. The penalty was financial and low to the point of being addressed as symbolic, since the Agency concluded that the bakers/craftsmen who participated in the forbidden agreement did not have significant market power in the market they operated. This case can be compared to the part of the *Lex Iulia de Annona* which forbids any forms of association by means of which the price of wheat and grain may be increased. It is clear that the mentioned agreement between the bakers was directly at the expense of the consumers of their products. Coincidently, this contemporary case deals with a similar everyday item, which consumers consume on a daily basis. Resembling the *United Brands* case, this case shows that restrictions of associations between professional sellers are not something entirely new, but rather a continuation of the old practice of consumer protection. It also demonstrates the need to continuously raise the protection of such buyers, which is in this sense done through competition law.

4. CONCLUSION

There are certain items, especially wheat and bread, which most people have to buy on a regular basis. Since they are pretty much irreplaceable to most of the population, sellers have manipulated to raise their prices since ancient times. On the one hand, it is completely normal, since every professional seller is striving to achieve higher prices for less input. However, there is a certain point up to which prices of such items can go and still not disturb the thin balance between the profit of sellers and the satisfaction and security of buyers. Such line is easily overstepped. It is on the public authority to intervene in mentioned cases, because it is a public interest to protect such buyers, who are a vulnerable group of citizens, dependable on sellers of such items. This was recognized in ancient times, and this paper shows that many legislative acts were adopted to solve this kind of crisis and to help consumers. There is a certain irony to the fact that the problem is still present today, and it gives the impression that all those solutions were defective and faulty. This kind of contemplation and attitude is wrong. All the above-mentioned solutions had their flaws, but it still does not mean that they did not accomplish their purpose, which was to protect the weaker party of the contract. As time goes by, sellers are finding new ways to raise their prices, and to show it as the answer to the problems of shipment of goods, import and other issues with which they struggle. Sometimes it is really because of the mentioned obstacles, but often it is not the case. This paper has demonstrated the evolution of consumer protection in this sense and showed that similar problems are encountered today, and will be encountered tomorrow. As Diocletian stated that he was aware of the legislation of his predecessors, modern legislators should be aware of this as well, and should continue in same direction, with regular adjustments to the contemporary and current state of society. In addition, it is up to Croatian Competition Agency on the national level and to the European Commission on the EU level to monitor and intervene if they suspect abuse of dominant position in order to keep the market healthy, but also to consequentially protect consumers.

LITERATURE:

1. Akman, P., Garrod, L. (2011). When Are Excessive Prices Unfair?, in *Journal of competition law and economics,* 7 (2), Oxford: Oxford University Press.

2. Benedict, R. (1909). The Historical Position of the Rhodian Law, in *The Yale Law Journal,* Vol. 18, No. 4, Yale: The Yale Law Journal Company, Inc.
3. Berger, A. (1953). *Encyclopaedic Dictionary of Roman Law*, Philadelphia: The American Philosophical Society
4. Böckh, A. (1838). *Metrologische Untersuchungen über Gewichte, Münzfüsse, und Masse des Alterthums*, Berlin: Verlag von Veit und Comp.
5. Braund, D. (1993). Piracy under the principate and the ideology of imperial eradication, in Rich. J. and Shipley, G. (eds.), *War and society in the Roman World,* London: Psychology Press
6. Brunt, P. A., Moore, J.M. (1967). *Res Gestae Divi Augusti - The Achievements Of the Divine Augustus*, Oxford: Oxford University Press
7. Buckland, W. (1912). *Elementary Principles of the Roman Private Law*, Cambridge: Cambridge University Press
8. Case 27/76 - Judgment of the Court of 14 February 1978. - United Brands Company and United Brands Continentaal BV v Commission of the European Communities - Chiquita Bananas, Retrieved 24.04.2017. from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61976CJ0027
9. Charter of Fundamental Rights of the European Union (2012). 2012/C 326/02. Retrieved 24.04.2017. from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12012P/TXT
10. Consolidated version of the Treaty on the Functioning of the European Union (2012). OJ C 326. Retrieved 24.04.2017. from http://eur-lex.europa.eu/legal-content/HR/TXT/?uri=CELEX:12012E/TXT
11. Divković, M. (1900). *Latinsko-hrvatski rječnik*, Zagreb: Kr. zemaljska tiskara
12. Ermatinger, J. W. (1996). *The Economic Reforms of Diocletian*, St. Katharinen: Scripta Mercaturae
13. Hekster, O. Zair, N. (2008). *Rome and Its Empire, A.D. 193–284*, Edinburgh: Edinburgh University Press Ltd
14. Hopkins, K. (1978). *Conquerors and Slaves, Sociological Studies in Roman History Volume 1*, Cambridge: Cambridge University Press
15. Jaramaz Reskušić, I. (2006). Augustove reforme kaznenog prava i pravosuđa, *in Hrvatski ljetopis za kazneno pravo i praksu*, Vol.13 No.1, Zagreb: Croatian Association of Sciences and Practice
16. Kessler, D., Temin, P. (2007). The Organization of the Grain Trade in the Early Roman Empire, in *The Economic History Review, New Series, Vol. 60, No. 2.*, Wiley on behalf of the Economic History Society
17. Kropff, A. (2016). *An English translation of the Edict on Maximum Prices, also known as the Price Edict of Diocletian*. Retrieved 24.04.2017. from http://www.academia.edu/23644199/New_English_translation_of_the_Price_Edict_of_Diocletianus.
18. Mommsen, T. (1844). *Die römischen Tribus in administrativer Beziehung*, Altona: J. F. Hammerich
19. Rickman, G. (1980). *The Corn Supply of Ancient Rome*, Oxford: Oxford University Press
20. Rješenje Agencije za zaštitu tržišnog natjecanja, klasa: UP/I 030-02/11-01/039 od 26. srpnja 2012. *Official Gazette* No. 102/2012.

21. Scott, S. P. (1932). *The Civil Law*. Retrieved 24.04.2017. from http://droitromain.upmf-grenoble.fr/Anglica/D48_Scott.htm#XII
22. Smith, W. (1859). *Dictionary of Greek and Roman Antiquities*, Boston: Little, Brown and Company
23. Tatum, J.W. (1990). Cicero's Opposition to the Lex Clodia de Collegiis, *in The Classical Quarterly*, Vol. 40, No. 1., Cambridge: Cambridge University Press
24. Zakon o zaštiti tržišnog natjecanja, *Official Gazette* No. 79/09, 80/13
25. Žiha, N. (2012). *Fenus nauticum kao preteča prava osiguranja* (Doctoral dissertation). Zagreb.

THE EUROPEAN AND CROATIA SMALL CLAIMS PROCEDURE AND APPERTAINING LEGAL PRINCIPLES

Zaklina Harasic
Faculty of Law, University of Split, Croatia
zaklina.harasic@pravst.hr

Marin Kersic
Faculty of Law, University of Split, Croatia
marin.kersic@pravst.hr

ABSTRACT

This paper deals with the small claims procedure at EU level and at the level of the Republic of Croatia, viewed through the prism of principles and the extent to which these principles are implemented in respective cases. The small claims procedure refers to matters in which the value of the claim does not exceed a certain amount prescribed by the procedural rules of a country or by the bilateral treaties of the countries concerned – which is the case with the European small claims procedure. Since the rules for small claims litigation result from a compromise between the de minimis non curat praetor principle and the requirement that the parties shall be granted legal protection of their rights, the appertaining action is brought where the value of the claim is small, and is subject simplified procedural rules, which can reduce the quality of legal protection. Structurally, the paper begins with an overview of the European small claims procedure introduced by Regulation (EC) No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European Small Claims Procedure, but it also makes special reference to Regulation (EU) 2015/2421 of the European Parliament and of the Council of 16 December 2015 amending Regulation (EC) No 861/2007. After presenting the European small claims procedure, the paper depicts how Croatian law handles this issue, which is regulated by the Civil Procedure Act. After making observations to the two procedures, the paper attempts to answer the question to which degree the following principles are implemented thereby: first, the principle of judicial efficiency as the fundamental principle in small claims litigation; second, the right to be heard principle; third, the principle of immediacy; fourth, the principle of orality and literacy and fifth, the principle of providing assistance to ignorant (illiterate) parties. Based on the answer to this question, the author draws some conclusions with respect to small claims litigation within Croatian law.

Keywords**:** *Croatian procedure, European procedure, legal principles, small claims litigation*

1. INTRODUCTION

The small claims procedure can be initiated both at EU (European small claims procedure) and at national level in matters in which the value of a claim does not exceed a certain amount prescribed by respective procedural rules. It is believed that the rules for small claims litigation result from a compromise between the radical application of the *de minimis non curat praetor* principle and the aspiration to provide the parties with procedural guarantee for the legal protection of their rights, so litigation initiation is permitted if it concerns a small monetary claim, but it is then subject to simpler rules, which brings to reduction of the quality of possible legal protection (Triva, Dika, 2004, pp. 818-819). This paper presents both the Croatian and the European small claims procedure.

The author holds that they are comparable and that one should investigate whether the European small claims procedure contains better solutions with respect to the Croatian small claims procedure or not and what are those advantages. In case the answer to this question is positive, some *de lege ferenda* conclusions in regard to the Croatian small claims procedure will be drawn.

2. EUROPEAN SMALL CLAIMS PROCEDURE

2.1. Term, scope and reasons for its introduction

The European small claims procedure was introduced by *Regulation (EC) No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European Small Claims Procedure* (Official Journal of the European Union L 199, 31 July 2007, pp. 1-22, hereinafter: Regulation). At this point it should be noted that the adoption of the said Regulation was followed, in 2015, by the adoption of *Regulation (EU) 2015/2421 of the European Parliament and of the Council of 16 December 2015 amending Regulation (EC) No 861/2007 establishing a European Small Claims Procedure and Regulation (EC) No 1896/2006 creating a European order for payment procedure* (Official Journal of the European Union L 341, 24 December 2015, pp. 1-14, hereinafter: 2015 Regulation) which shall be applicable, with one exception, from 14 July 2017. The text below involves an overview of the Regulation, accompanied with relevant amendments thereto introduced by the 2015 Regulation.

Introducing the European small claims procedure, the scope of the Regulation refers to cross-border small claims litigation. The Regulation also mentions the alternative character of the procedure or in other words, that it can be applied for by litigants along with the procedures under the laws of the Member States (Article 1 paragraph 1 of the Regulation). The scope of the Regulation also relates to the elimination of the intermediate proceedings necessary to enable recognition and enforcement, in other Member States, of judgments given in one Member State within the European Small Claims Procedure (Article 1 paragraph 2 of the Regulation). Besides, the Regulation is primarily aimed at simplifying and speeding up litigation concerning small claims in cross-border cases, and at reducing costs (Article 1 paragraph 1 of the Regulation, item 8 of the Preamble to the Regulation).

The scope of the Regulation comprises cross-border cases commenced due to civil and commercial matters, whatever the nature of the court or tribunal, where the value of a claim does not exceed EUR 2 000 (noting that the 2015 Regulation raises this limit to EUR 5 000) at the time when the claim form is received by the court or tribunal with jurisdiction, excluding all interest, expenses and disbursements (Article 2 paragraph 1 of the Regulation). The Regulation shall not apply to cases referring to: (1) revenue, customs or administrative matters or to the liability of the State for acts and omissions in the exercise of State authority; (2) the status or legal capacity of natural persons; (3) rights in property arising out of a matrimonial relationship, maintenance obligations, wills and succession; (4) bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings; (5) social security; (6) arbitration; (7) employment law; (8) tenancies of immovable property, with the exception of actions on monetary claims and (9) violations of privacy and of rights relating to personality, including defamation (Article 2 paragraph 2 of the Regulation). *A cross-border case* is one in which at least one of the parties is domiciled or habitually resident in a Member State other than the Member State of the court or tribunal seized and determining whether there is a cross-border case depends on the date on which the claim form is received by the court or tribunal with jurisdiction (Article 3 of the Regulation). The Regulation shall apply in its entirety and be binding for all Member States except for Denmark from 1 January 2009 (Article 29 paragraph 2 in relation to Article 2 paragraph 3 of the Regulation).

The main reason for introducing the European small claims procedure is simplification of civil procedures for small claims litigation since costs, delays and complexities connected with cross-border small claims litigation are considerable (item 7 of the Preamble to the Regulation). Moreover, since most Member States have already adopted their own small claims procedures, it is necessary to harmonize the possibilities of creditors within the EU in order to ensure a level playing-field on the entire EU territory (item 7 of the Preamble to the Regulation).

2.2. Procedure

The European Small Claims Procedure shall be a written procedure (Article 5 paragraph 1 of the Regulation) which is initiated by filling out and submitting Claim Form A (Annex I to the Regulation) to the court or tribunal with jurisdiction directly, by post or by any other means of communication, such as fax or e-mail, acceptable to the Member State in which the procedure is commenced (Article 4 paragraph 1 of the Regulation). After the court or tribunal receives a duly completed claim form, it shall fill in Part I of Answer Form C (Annex III to the Regulation).

The defendant shall submit his response within 30 days of service of the claim form and answer form (Article 5 paragraph 3 of the Regulation). Within 30 days of receipt of the response from the defendant or the claimant, the court or tribunal shall (1) give a judgment; (2) demand further details concerning the claim from the parties within a specified period of time, not exceeding the deadline of 30 days; (3) take evidence; or (4) summon the parties to an oral hearing to be held within 30 days of the summons (Article 7 paragraph 1 of the Regulation). The judgment shall be served on and not pronounced to the parties (Article 7 paragraph 2 of the Regulation).

The applicable procedural law shall be the procedural law of the Member State in which the procedure is conducted, if not otherwise stipulated by the Regulation (Article 19 of the Regulation).

As far as legal remedies are concerned, Member States shall inform the Commission whether an appeal is available under their procedural law against a judgment given in the European Small Claims Procedure and within what time limit such appeal shall be lodged. The Commission shall make that information publicly available (Article 17 of the Regulation).

In that sense, an appeal against a judgement within the small claims procedure is permitted pursuant to the provisions of the CPA on the legal remedy in small claims disputes.

3. CROATIAN SMALL CLAIMS PROCEDURE

3.1. The term of small claims procedure

The Croatian legal system is not familiar with the idea that courts can refuse to adjudicate in cases which might be deem trivial (Uzelac, 2014, p. 22). The small claims procedure is in Croatian law regulated by the Civil Procedure Act (hereinafter: CPA). The subject matter in small claims litigation (disputes) was significantly amended by the 2008 Novel and the 2013 Novel. This paper depicts the latest status – since the 2013 Novel.

The small claims procedure is prescribed in Title Thirty of the CPA and the things that have not been regulated by the provisions of that Title are subject to other provisions of the CPA. Small value disputes (sometimes Croatian authors call them bagatelle or minor disputes – ''bagatelni or malični sporovi'' in Croatian) are disputes which are defined by three positive criteria and which include condemnatory claims (Triva, Dika, 2004, p. 819): (1) disputes in which the pecuniary claim does not exceed 10,000.00 HRK (Article 458 paragraph 1 of the CPA), while in regard to commercial courts, the upper threshold is 50,000.00 HRK (Article 502 paragraph 1 of the CPA): (2) disputes in which the claim is not pecuniary and the claimant has laid down a procedural alternative obligation, i.e. he/she has specified in the

complaint that he/she is willing to accept, instead of a relief, an amount of money not exceeding 10,000.00 HRK (Article 458 paragraph 2 of the CPA), whereas concerning commercial courts, the limit is 50,000.00 HRK (Article 502 paragraph 2 of the CPA): (3) disputes in which the object of the claim is not an amount of money but delivery of a moveable item, the value of which, as specified by the claimant in the complaint, does not exceed the amount of 10,000.00 HRK (Article 458 paragraph 3 of the CPA), while with respect to commercial courts, the maximum claim value is 50,000.00 HRK (Article 502 paragraph 3 of the CPA). Let us make two more remarks: the first one refers to cases in which the claimant amends the claim and such amendment results in the amount in controversy exceeding 10.000,00 HRK, which implies that the proceedings shall be finalized according to the provisions of the CPA, that regulate ordinary (regular) proceedings (Article 464 paragraph 1 of the CPA), whereas what matters before commercial courts in this view is amendment resulting in the amount in controversy exceeding 50,000.00 HRK (Article 502 paragraph 1 of the CPA); the second remark relates to cases in which the plaintiff has reduced the claim before the conclusion of the trial conducted according to the provisions of the CPA on ordinary proceedings and, as a result, the claim does not exceed the amount of 10.000,00 HRK any longer. In such cases, the proceedings shall be continued according to the provisions of the CPA on small claims disputes (Article 464 paragraph 2 of the CPA); amendment resulting in the amount not bigger than 50,000.00 HRK is in this context relevant for commercial courts (Article 502 paragraph 1 of the CPA).

Along with positive criteria, there are some negative criteria pertaining to small claims disputes or in other words, the question is which disputes are not regarded as small claims disputes. Small claims disputes do not involve: (1) immovable property disputes; (2) employment-related disputes initiated by workers against a decision on termination of his/her employment contract (3) and trespass-related disputes (Article 459 of the CPA). Procedures resulting from small claims disputes shall also be conducted with regard to objections against motions for ex parte payment order, provided that the value of the contested part of the motion does not exceed the amount of 10,000.00 HRK (Article 460 of the CPA), while with respect to commercial courts, this limit is 50,000.00 HRK. Although the initiation of the small claims procedure before commercial courts is not explicitly envisaged, the author believes that the legislator intended (teleological interpretation) to encompass commercial courts by this possibility too (similarly, Dika, 2009, p. 7, stating *argumentum a cohaerentia* and *argumentum a completudine*). The threshold value issue is particularly important for procedures conducted before commercial courts which are supposed to resolve factually and legally complex cases that, due to the value requirement, fall within the small claims procedure (this problem has already been singled out by Benzon, Vujeva, 2015, p. 26). Besides, special regulations explicitly set forth that maintenance disputes are never qualified as small claims disputes (Article 423 of the Family Act).

The provisions of the CPA, which explicitly refer to proceedings revolving around small claims, which are initiated before lower courts of first instance, regulate the following issues as well: delivery of the claim to the respondent for the purpose of giving response to the claim (Article 461.a of the CPA); rules for presenting new facts and evidence (Article 461.a of the CPA); the possibility of challenging a court's jurisdiction (Article 461.b of the CPA); the possibility of lodging an appeal (Article 462 of the CPA); details about the minutes of a hearing (Article 463 of the CPA); consequences of a failure of one or both parties to appear at a hearing (Article 465 of the CPA); delivery of summons to the parties (Article 465 paragraph 3 of the CPA); rule on judgement aggregation (Article 466 of the CPA); the duty of instructing the parties about the legal remedy (Article 466 paragraph 2 of the CPA); the possibility of revision (Article 467.a of the CPA).

4. LEGAL PRINCIPLES IN THE EUROPEAN AND THE CROATIAN SMALL CLAIMS PROCEDURE

Both the European and the Croatian small claims procedure take account of some legal principles. While the provisions of the European small claims procedure contain the foundations which this procedure is based on, the grounds for the Croatian small claims procedure are not explicitly indicated. The reason for this omission is that the appertaining principles or more precisely, the provisions constituting their grounds can be found in other Titles of the CPA. There are two reasons why the principles relating to small claims disputes are mentioned here. The first one is that principles appear to be the highest general legal standards which all the other standards shall be based on. The other one is that legal principles define the nature of a procedure and the position of the court, parties and possibly, other participants therein. The chapters below attempt to provide answers to some questions, the most relevant ones being what is the relation between the principles laid down in the provisions of the European small claims procedure and the principles referring to the Croatian small claims procedure, and if the principles applying to the European and the Croatian small claims procedure can be applied in the same way as in disputes in which the value of a claim is not small. Before giving answers to these questions, let us say something generally about legal principles.

4.1. On legal principles in general

Legal principles are a type of general legal standards or more precisely, they are the highest general legal standards (Visković, 2006, p. 175). Other legal standards have to be harmonized with legal principles since they are the highest standards of a legal system and promote fundamental values thereof (Visković, 2006, p. 252). Van Hoecke asserts that principles are standards that are expressed by virtue of general terms (notions), that have a broad scope of application and that promote values which are considered fundamental for a legal system or some of its segments (Van Hoecke, 2002, p. 160). There are some divisions of legal principles and attempts of their systematization which are not elaborated in detail in this paper (for more details thereabout see Harašić, 2010, pp. 748-751). However, one can say that today a large of number of principles do not represent only a formulation provided by legal science and case-law but also legal standards, i.e. they have been incorporated into legal standards as their content. Many legal standards have been incorporated into constitutions and provisions that regulate criminal, civil and administrative procedures as well as into many substantive law standards. Hence, the general provisions of the CPA, which apply both to ordinary (regular) procedures and the small claims procedure, contain the following principles (though there are no special provisions on small claims disputes in Title Thirty of the CPA): the principle of disposition (Article 3 paragraph 1 of the Regulation), the oral hearing principle (Article 4 of the Regulation), the principle of an written process (Article 14 of the Regulation), the principle of immediacy (Article 5 paragraph 1 of the Regulation), the principle of publicity (Article 5 paragraph 1 of the Regulation), the right to be heard (hearing both sides) principle (Article 5 paragraph 1 of the Regulation), the principle of judicial efficiency (Article 10 paragraph 1 of the Regulation), the principle of conscientious utilization of procedural entitlements (Article 9 of the Regulation) and the principle of providing assistance to ignorant (illiterate) parties (Article 11 of the Regulation). The provisions of the Regulation explicitly denote the following principles: the principle of judicial efficiency (Article 1 paragraph 1 of the Regulation), the principle of proportionality (item 7 of the Preamble to the Regulation), the principle of an adversarial process (item 9 of the Preamble to the Regulation), the principle of orality and literacy (Article 5 of the Regulation) and the principle of providing assistance to ignorant (illiterate) parties (item 21 of the Preamble to the Regulation and Article 11 of the Regulation).

The following principles are comprised by both the European and the Croatian small claims procedure: the principle of judicial efficiency, second, the right to be heard (hearing both sides) principle, the principle of orality and literacy), the principle of providing assistance to ignorant (illiterate) parties.
The theory of civil procedure as well as the theory of criminal procedure attributes certain functions to fundamental principles. These are the interpretative and the productive function. ''Enforcers of legal rules see legal principles as a bookmark in the interpretation of legal rules, particularly when a legal rule wording involves no direct answer to a formulated problem or when a grammatical and logical interpretation are themselves not sufficient for finding a solution which will be in compliance with the general nature of a particular legal system'' (Triva, Dika, 2004, p. 114).
Similarly to Triva and Diva, Krapac, when interpreting regulations, provides legal principles with a purpose and that is: ''...enable court to, for instance, resolve an issue when common methods of the interpretation of legal regulations (the so-called grammatical, logical method and other methods) are of no use (Krapac, 2000, p. 45).

4.2. The principle of judicial efficiency

In its broadest sense, the principle of judicial efficiency requires that a procedure is completed within the shortest possible period of time and with as few assets and costs as possible. Economical handling of cases implies that proceedings shall be conducted in a way that its costs does not exceed the value of the legal interest, the protection of which constitutes the dispute (Triva, Dika, 2004, p. 145). Protection or exercise of subjective rights in proceedings shall be ensured within a reasonable period of time in order to be really valuable (Galič, p. 808). It is beyond any doubt that this entails efficiency in ordinary (regular) proceedings and not in small claims disputes. Still, the court is obliged to provide legal protection even in small claims disputes, i.e. in those in which the costs exceed the value of the dispute.
If the provisions of the Regulation and the provisions of the CPA are compared, it becomes clear that the Regulation explicitly mentions the principal of judicial efficiency whereas this is not the case with the provisions of the CPA, which regulate the subject matter in small claims disputes. Nevertheless, the normative framework of the Croatian small claims procedure reveals that the principle of judicial efficiency is taken into consideration in those provisions of the CPA too, as demonstrated below.

4.2.1. European procedure

As laid down in its Article 1 paragraph 1, the Regulation is aimed at simplifying and speeding up litigation concerning small claims in cross-border cases, and at reducing costs. Apart from that, items 8 and 23 of the Preamble to the Regulation highlight simplicity, promptness and efficiency as the main goals of the Regulation and the procedure regulated thereby.
The principle of judicial efficiency is implemented through standardized forms, starting from claim Form A, by virtue of which the claimant initiates the European small claims procedure since the content of the form comprises all the relevant aspects for procedure commencement (hence, the principle of providing assistance to ignorant (illiterate) parties is also implemented). The principle of judicial efficiency shall be implemented within certain deadlines, which are short: after receiving the properly filled in claim form, the court or tribunal shall fill in Part I of the standard answer Form C and send it together with the claim Form A to the respondent within 14 days after receiving the claim Form A; the defendant shall submit his response within 30 days of service of the claim form and answer form; within 14 days of receipt of the response from the defendant, the court or tribunal shall dispatch a

copy thereof, together with any relevant supporting documents to the claimant; the court or tribunal shall make a respective decision or undertake other action within 30 days after receiving the respondent's response (see 2.2.). Moreover, in regard to taking evidence, Article 9 paragraph 3 of the Regulation sets forth that ''the court or tribunal shall use the simplest and least burdensome method of taking evidence'' and Article 9 paragraph 2 of the Regulation prescribes that ''the court or tribunal may take expert evidence or oral testimony only if it is necessary for giving the judgment. In making its decision, the court or tribunal shall take costs into account". In terms of taking evidence, the Preamble instructs that ''the court or tribunal should use the simplest and least costly method of taking evidence" (item 20 of the Preamble to the Regulation). The judgment shall be enforceable notwithstanding any possible appeal (Article 15 paragraph 1 of the Regulation).

4.2.2. Croatian law

The Croatian Civil Procedure Act does not explicitly lay down the principle of judicial efficiency in the Title referring to small claims disputes. Yet, that principle is incorporated into other provisions of the CPA, which relates to small claims disputes. Namely, Article 10 paragraph 1 of the CPA stipulates that the court is obliged to conduct the proceedings without causing any delays, within a reasonable time, and with the minimum of costs, and prevent any form of abuse of rights in the proceedings. The parties shall present new facts and evident in the claim or in the response to the claim, meaning prior to the preliminary (pre-trial) hearing while at the preliminary (pre-trail) hearing, they can present new facts and evidence only if they were prevented (no-fault of theirs) from taking and presenting those facts and evidence earlier (Article 461.a. paragraphs 2 and 3 of the CPA). This provision was aimed at achieving a higher level of the procedural discipline of parties or in other words, it binds the parties to present all the decisive facts and evidence to the court in an early stage of the procedure in order to diminish the possibility of abusing their right to present new facts and evidence. The provisions on declaring a lack of subject matter and territorial jurisdiction of a court contribute to the implementation of the principle of judicial efficiency since the court is entitled to do that ex offo or following a proposal of a party. That can be done until the claimant is granted the possibility to discuss about the subject matter of the dispute (Article 461.b of the CPA).

The application of the principle of judicial efficiency should be encouraged by the conciseness of the minutes of hearings in small claims disputes. The specificity of these minutes is that they need to be more concise than the minutes of ordinary (regular) proceedings. The content of the minutes is reduced with respect to noting down parties' statements and the content of taken evidence. The minutes shall contain relevant data. Those data are not exhaustive and the court may, depending on the circumstances in the case, incorporate other data into the minutes, which are deemed crucial for making a decision on the claim (Jurić, Kristofić, 2013, p. 561).

The efficiency of a procedure is facilitated by the provisions on the consequences of failing to appear at a hearing. Indeed, if the claimant fails to appear at the first trial hearing although he or she has been properly summoned, it shall be considered that he or she has withdrawn the claim, unless the respondent embarks on discussing about the subject matter (Article 465 paragraph 1 of the CPA); If both parties fail to appear at any subsequent hearing, the court shall adjourn the hearing. If both parties fail to appear at a further hearing as well, it shall be considered that the claimant has withdrawn the claim (Article 465 paragraph 2 of the CPA).

The requirement for using legal remedies – appeal and revision – suggests that the principle of judicial efficiency is taken account of. A judgement or decree, which represents the final stage of the European small claims procedure, may be contested in an appeal (Article 462 of the CPA). It is certain that the principle of judicial efficiency is the main principle both in the

European and the Croatian small claims procedure. This thesis arises from a large number of provisions referring to small claims disputes. Are some solutions from the European small claims procedure applicable to its Croatian equivalent? It seems that standardized forms could be used in the Croatian small claims procedure too.

4.3. The right to be heard (hearing both sides) principle

According to the European Convention for the Protection of Human Rights and Fundamental Freedoms, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law (Article 6 paragraph 1 of the Convention), and pursuant to the Constitution of the Republic of Croatia, everyone shall be entitled to have his or her rights and obligations, or suspicion or accusation of a criminal offence decided upon fairly before a legally established, independent and impartial court within a reasonable period of time (Article 29 paragraph 1 of the Constitution of the Republic of Croatia (Triva, Dika, 2004, p. 148).

4.3.1. European procedure

Item 9 of the Preamble to the Regulation proclaims that the court or tribunal should respect the right to a fair trial and the principle of an adversarial process, in particular when deciding on the necessity of an oral hearing and on the means of taking evidence and the extent to which evidence is to be taken. As a written procedure, the European small claims procedure is conducted by means of forms in a way that the claim Form A serves as an instrument for initiating the procedure while the form C is together with the Form A (if there are no requests for amendment and/or modification of the claim – Form B) sent to the respondent by the court for the purpose of giving response to the claim.

4.3.2. Croatian law

In the Title of the CPP, which refers to small claims disputes, there are no explicitly formulated principles, but since other provisions of the CPA are applicable to small claims disputes too, one can say that Article 5 paragraph 1 of the same Act bears certain relevance in this context, promoting that the court shall give an opportunity to every party to enter his or her plea regarding the claims and allegations made by the opposing party. Considering that the above provision of the European small claims procedure mentions the principle of an adversarial process, there is a dilemma if this provision of the CPA concerns the principle of an adversarial process or the right to be heard (hearing both sides) principle. The appertaining literature is not unanimous in this light. Some authors claim that this is the principle of an adversarial process (Jurić, Kristofić, 2013, p. 36) and others think that this must be the right to be heard (hearing both sides) principle (Triva, Dika, 2004, p. 147). The author of this paper is more prone to the latter standpoint – that the provision concerned encourages the implementation of the right to be heard principle (*audiatur et altera pars*) both in the Croatian and the European small claims procedure. In my opinion, the right to be heard (hearing both sides) principle appears to be an aspect of the principle of an adversarial process since hearing both sides provides the parties in the proceedings to state what they think about the allegations of the other party.

4.4. The principle of immediacy and mediacy

The principle of immediacy or mediacy is primarily based on the method of taking evidence. It stipulates as follows: first, that the court, using its senses, shall observe evidence in a way that there are no mediators between the court and the source of information; second, that the court that directly observes evidence shall decide on its probative value; and third, that the same court shall deliver a judgement after concluding the adversary hearing at which it collected facts and evidence (Triva, Dika, 2004, p. 186).

4.4.1. European procedure

The provisions regulating the European small claims procedure do not explicitly disclose whether the principle of immediacy or mediacy is applied when taking or evaluating evidence. In fact, the Regulation does envisage taking evidence, but it does not say anything about taking evidence in a direct or an indirect manner. It mentions taking evidence through written statements of witnesses, experts or parties as well as by means of video conference or other communication technology (Article 9 paragraph 1 of the Regulation) or modern communication technology (item 20 of the Preamble to the Regulation, Article 4 paragraph 2 of the Regulation), and through expert evidence or oral testimony (Article 9 paragraph 2 of the Regulation). In any case, the court or tribunal shall use the simplest and least burdensome method of taking evidence (Article 9 paragraph 3 of the Regulation). This can be perceived in a way that evidence shall be taken directly or indirectly, depending on what is easier in a concrete case.

Since the European small claims procedure is a written procedure, it can be concluded that most evidence is submitted in writing and thus the majority of evidence has the indirect character. Due to the fact that the initiation of the European small claims procedure mostly results from cross-border disputes, taking evidence indirectly seems to be very convenient.

4.4.2. Croatian procedure

In terms of the Croatian small claims procedure, it has not been specified if evidence is to be taken directly or indirectly. Therefore, the provisions of the CPA apply, which stipulate that the court shall decide on a claim on the basis of oral, direct and public trials (Article 4 of the CPA). This implies that in small claims disputes, evidence is mostly taken and evaluate directly.

The author holds that the formulation in the Regulation, which does not reveal whether evidence is taken and evaluate directly or indirectly, is more convenient in this light since the application of the least burdensome method is preferred, which means that sometimes it is easier to take evidence directly and sometimes indirectly.

4.5. The principle of an oral and written process

The oral hearing and written submission principle (of literacy and orality) refers to the *method* of a procedure (Triva, Dika, 2004, p. 189). If this principle was construed extremely, it would, require, on one hand, that all procedural actions shall be undertaken orally – and this would mean that the court would adjudicate only on the basis of discussion (written submissions of the parties would only have the meaning of prior notification on action which is intended to be taken orally) (Triva, Dika, p. 189)), and, on the other hand, that all actions shall be undertaken in writing. Naturally, it is not possible, at least not in contemporary law, that all the procedural actions are undertaken exclusively orally or only in writing.

4.5.1 European procedure

The European Small Claims Procedure shall be a written procedure, except in the event the court or tribunal shall hold an oral hearing if it considers this to be necessary or if a party so requests. One should bear in mind that the court or tribunal may refuse such a request (though it is obliged to state the grounds for the refusal in writing) if it considers that with regard to the circumstances of the case, an oral hearing is obviously not necessary for the fair conduct of the proceedings (Article 5 paragraph 1 of the Regulation, item 14 of the Preamble to the Regulation). In line with Article 8 of the Regulation, the court or tribunal may hold an oral hearing through video conference or other communication technology. As far as the manner of taking evidence is concerned, the court or tribunal shall use the simplest and least burdensome method of taking evidence (Article 9 paragraph 3 of the Regulation).

Guided by the principle of judicial efficiency as the primary principle in the European small claims procedure (Article 1 paragraph 1 of the Regulation, item 8 of the Preamble to the Regulation), it is logical that European small claims procedure prefers written petitions. This should be paid particular attention since *cross-border disputes* revolve around *small* claims and an oral hearing would slow down the procedure significantly and come into conflict with the principle of judicial efficiency.

4.5.2. Croatia law

The provisions governing the subject matter in small claims disputes are not specific about the written or oral character of the procedure. The applicable provisions of the CPA set forth that as a rule, courts shall decide claims on the basis of oral, direct and public trials. (Article 4 of the CPA). The said provision suggests that the CPA has embraced the written character of trials, but not in an absolute sense. The CPA also envisages that if for particular action, the law does not specify in which form they may be undertaken, the parties shall undertake procedural actions either in writing outside of the hearing or orally at a hearing (Article 14 of the CPA). The solution of the CPA, according to which, most actions in a dispute can be carried out both orally and in writing occurs to be well-formulated – the form of action is in a concrete case adapted to the goal of a procedure – passing a fair and lawful judgment, and to the capacity (ability) of parties and other participants in the procedure.

4.6. The principle of providing assistance to ignorant (illiterate) parties

The principle of providing assistance to ignorant (illiterate) parties primarily relates to the issue of balancing the equality of parties with their level of education, financial status and the possibility of hiring representatives in trial (Triva, Dika, 2004, p. 198). Due to the fact that the parties in small claims disputes face the problem of communicating with parties from foreign countries, which makes the procedure even more complicated, the principle of providing assistance to ignorant (illiterate) parties shall be implemented through the availability of information, online instructions and similar.

4.6.1. European procedure

The principle of providing assistance to ignorant (illiterate) parties is reflected in Article 11 of the Regulation, setting out that the Member States shall ensure that the parties can receive practical assistance in filling in the forms (Forms A, B, C). Such practical assistance should include technical information concerning the availability and the filling in of the forms (item 21 of the Preamble to the Regulation).

In regard therewith, great efforts have been invested into making the citizens familiar with the European small claims procedure, particularly via the Internet (European E-Justice Portal) and accompanying guides.

The parties should not be obliged to be represented by a lawyer or another legal professional (item 15 of the Preamble to the Regulation). At this point, the principle of the equality of parties is largely considered since the forms and assistance in filling them are available to the same extent to all the interested parties.

Practical assistance with regard to the forms foreseen for the procedure should be made available to the parties (item 21 of the Preamble to the Regulation).

Member States shall ensure that the claim form is available at all courts and tribunals at which the European Small Claims Procedure can be commenced (Article 4 paragraph 5 of the Regulation).

4.6.2. Croatian law

The principle of providing assistance to ignorant (illiterate) parties is not specifically laid down in the Title of the CPA, which refers to small claims disputes, so other provisions of the CPA are relevant for this principle, in particular the provisions setting out that the party who, for reasons of ignorance, fails to avail himself or herself of the rights belonging to him or her under this Act shall be instructed by the court as to which procedural actions he or she may take (Article 11 paragraph 2 of the CPA). Yet, among the provisions regulating the European small claims procedure, there is a provision which relates to the announcement of the judgement and which, in a way, confirms the implementation of the principle of providing assistance to ignorant (illiterate) parties since it sets forth that the court shall inform the parties present about the conditions under which they may lodge an appeal (Article 466 paragraph 2 of the CPA). This duty of the parties is an integral part of the minutes of hearings within the Croatian small claims procedure (Article 463 paragraph 1 item 4 of the CPA).

5. CONCLUSION

This paper presents and compares the Croatian and the European small claims procedure as well as offers answers to the question whether the European small claims procedure contains better solutions with respect to the Croatian one or not and what are those advantages. The small claims procedure can be initiated both at EU (European small claims procedure) and at national level in matters in which the value of a claim does not exceed a certain amount prescribed by respective procedural rules. The relation between the European and the Croatian small claims procedure is viewed here primarily with respect to the legal principles they are based on. There are at least two reasons why the principles relating to small claims disputes are mentioned in this paper.

The first one is that principles appear to be the highest general legal standards which all the other standards shall be based on. The other one is that legal principles define the nature of a procedure and the position of the court, parties and possibly, other participants therein. It has been established in this paper that the following principles are comprised by both the European and the Croatian small claims procedure: the principle of judicial efficiency, the right to be heard (hearing both sides) principle, the oral hearing and written submission principle (of orality and literacy, the principle of an oral and written process) and the principle of providing assistance to ignorant (illiterate) parties.

The way of formulating the principles in the Regulation and in the Croatian CPA reveals two approaches: while the Regulation (in its Preamble and normative part) explicitly mentions the above principle, the CPA is not so specific in this view in the Title referring to small claims disputes which are thus subject to the general provisions of the CPA, that explicitly denote those principles which apply to both ordinary (regular) proceedings and small claims disputes. A number of provisions of the Regulation and the CPA promote the application of the principle of judicial efficiency and it is evident that this principle represents a guiding light for the court and the parties to the proceedings. What needs to be stressed in this context is the usage of standardized forms within the European small claims procedure, which greatly contributes to the implementation of the principle of judicial efficiency and the principle of providing assistance to ignorant (illiterate) parties. Besides, the European E-Justice Portal and supporting guides provide detailed instructions for using those forms. Furthermore, the promotion of modern communication technology also facilitates the implementation of the principle of judicial efficiency as the fundamental principle in small claims disputes, so this can be proposed *de lege ferenda* for application in Croatian law.

The principle of judicial efficiency often comes into conflict with other legal principles such as the truth-seeking principle and the principle of legality. Therefore, the principle of judicial efficiency should not prevail to a great extent over other principles. Otherwise, it may jeopardize reasonable achievement of the inherent quality and goals of judicial activities (Triva, Dika, 2004, p. 145).

LITERATURE:

1. Benzon, I., Vujeva, M. (2015). *Postupak u sporovima male vrijednosti. Analiza procesnih instituta u teoriji i praksi nakon Novele Zakona o parničnom postupku iz 2013*. Pravnik: časopis za pravna i društvena pitanja, vol. 48, no. 98., pp. 23-52.
2. Dika, M. (2009). *Novelirani postupak u sporovima male vrijednosti*. Zbornik radova Pravnog fakulteta Sveučilišta u Rijeci, vol. 30, no. 1., pp. 1-32.
3. European e-justice portal (https://e-justice.europa.eu/content_small_claims-42-en.do?init=true), retrieved 28.04.2017.
4. Galič, A. (2013). *Ograničenje mogućnosti iznošenja novota i cilj građanskoga parničnog postupka*. Zbornik Pravnog fakulteta u Zagrebu, vol. 63., no. 3-4, pp. 799-817.
5. Harašić, Ž. (2010). *Zakonitost kao pravno načelo i kao pravni argument*. Zbornik radova Pravnog fakulteta Sveučilišta u Splitu, vol. 47, no. 3, pp. 745-767.
6. Jurić, I., Kristofić, A. (2013). *Zakon o parničnom postupku: (redakcijski pročišćeni tekst s komentarom, sudskom praksom i bilješkama)*. Zagreb: Vizura.
7. Krapac, D. (2000). *Kazneno procesno pravo: Prva knjiga: Institucije*. Zagreb: Informator.
8. Obiteljski zakon (Narodne novine br. 103/15).
9. Regulation (EC) No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European Small Claims Procedure (Official Journal of the European Union L 199, 31 July 2007, pp. 1-22).
10. Regulation (EU) 2015/2421 of the European Parliament and of the Council of 16 December 2015 amending Regulation (EC) No 861/2007 establishing a European Small Claims Procedure and Regulation (EC) No 1896/2006 creating a European order for payment procedure (Official Journal of the European Union L 341, 24 December 2015, pp. 1-14).
11. Triva, S., Dika, M. (2004) *Građansko parnično procesno pravo* (7th ed.). Zagreb: Narodne Novine.
12. Uzelac, A. (2014). *Goals of Civil Justice and Civil Procedure in Contemporary Judicial Systems. Global Developments – Towards Harmonisation (and Back)*, in Uzelac, A. (ed.) (2014), Goals of Civil Justice and Civil Procedure in Contemporary Judicial Systems. Springer.
13. Van Hoecke, M. (2002). *Law as Communication*. Oregon: Hart Publishing.
14. Visković, N. (2006). *Teorija države i prava* (2nd ed.). Zagreb: Birotehnika.
15. Zakon o parničnom postupku (Narodne novine br. 53/91, 91/92, 58/93, 112/99, 88/01, 117/03, 88/05, 02/07, 84/08, 123/08, 57/11, 148/11, 25/13, 89/14).

ADVANTAGES AND DISADVANTAGES OF THE INFORMATION TECHNOLOGY USE IN THE WHISTLEBLOWING PROCESS

Zeljko Mirjanic
Faculty of Law, University of Banja Luka, Bosnia and Herzegovina
zemirjanic@gmail.com

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

ABSTRACT

Whistleblowing, being increasingly recognized as a necessary form of fight against corruption and other unethical acts, is spreading in both the European Union and the posttransitional countries of the Southeast Europe. In the whistleblowing process, we recognize open, confidential and anonimous whistleblowing, with the identity of whistleblowers usually protected by confidentiality. While open whistleblowing does not suppose identity protection, confidential whistleblowing requires detailed legal protection of whistleblowers identity, by law on whistleblowers protection or by law on personal data protection, or partly through labour law and civil servants law. The third type of whitleblowing, or anonimous whistleblowing means reporting corruption and unethical acts most often with the use of information technologies, such as online reporting plaftorms, smart phones applications, hotline calls, etc., when whistleblower's personality is hiden, with the information technologies playing the role of the identity protection, which in case of confidential whistleblowing is given to laws. These technologies enable receivers of corruption reports to have a dialogue with the whistleblower, investigate the accuracy of reports without revealing the anonimous person's identity. The subject of the analysis is a question of how the information technologies used in anonimous whistleblowing may substitute the identity protection at confidential whistleblowing, and what are the advantages and disadvantages of anonimous whistleblowing, comparing to confidential whistleblowing. A crucial question is whether the information technologies used in the whistleblowing process may alleviate the negative effects of inadequate legal protection, i.e. the lack of adequate legal protection or non-implementation of current legislation, which problem is pronounced in Southeast Europe. On the other hand, when the identity protection is not an issue, technology use enables far more important social influence to the protection of whistleblowers due to constant and timely informing the public on wrongdoings done against the whistleblowers or threats of being done.

Keywords: *anonimous whistleblowing, fight against corruption, identity protection, information technologies, open whistleblowing*

1. INTRODUCTION

Information technologies are being increasingly used for protected reporting of corruption and other violations of public interest (whistleblowing) in posttransitional countries of Southeastern Europe as well as in other countries (Mirjanic, 2016, p. 97). Apart from information revolution as a global factor of changes in the information, communication and other spheres, such a trend is influenced also by the universality of fight against corruption and use of information technologies in fight against crime. The universal character of fight against corruption is upheld by the United Nations Convention against Corruption (2003), which, speaking of preventive measures, provides that conracting states mutually cooperate and also together with international and regional organisations thrive to improve the policy

measures and praxis of prevention of corruption, and that the cooperation may include participation in international programmes and projects (Article 5). In the light of this cooperation it is necessary to use information and communication technology possibilities, especially regarding processing and exchange of data. The Convention provides that, as the collection, exchange and analyses of corruption data is concerned, contracting states shall deal with the possibility of analyses and mutual exchange, and that they shall develop common definitions, standards and methodologies as well as data on best praxis for prevention and fight against corruption, by using statistics and analytical expertise on corruption. (Article 61). According to the Convention, the fight against corruption includes protection of persons submitting a report: each contracting party shall discuss the possibility of forseeing in its legal system, for appropriate measures of protection from unjustified procedure against any person who reports in good faith and reasonably to competent bodies, any facts that relate to criminal acts linked with corruption (Article 33). Important attitudes on fight against corruption and the protection of whistleblowers are included in other acts as well such as: Civil Law Convention on Corruption (1999), European Parliament resolution of 23 October 2013 on organised crime, corruption and money laundering: recommendations on action and initiatives to be taken (final report) etc. Accordingly, in Resolution on whistleblower's protection No. 1729 (2010) of the Parliamentary Assembly of the Council of Europe, member states are invited to review their regulations on he protection of 'whistleblowers', having in mind certain principles. The importance of determining the whistleblowing is also seen in the invitation to the EU institutions to issue internal rules on whistleblowing. (Mirjanic, 2016, p. 102). Having in mind that the use of information technologies influences the possibility of whistleblowers to start whistleblowing and protect their identity, the rules on the use of this technology are subject of comprehensive legislative, about the protection of whistleblowers as an alternative to remain silent. Whistleblowers in various countries may use these technologies in the same manner, with the same or similar aims, and differences as to the importance of social relations that are being created in the process of whistleblowing due to the use of information and communication technologies, depend upon the level of the use of information technologies in some countries and the legislative on whistleblowers' protection. Contrary to posttransitional countries in Southeastern Europe which thrive to develop information society in which the use of information and knowledge will play a central role, in idustrially developed countries, information economy is a separate economic sector, and the influence of these technologies to economy, culture, politics and private sector constantly and quickly grows. Despite of expansion of number of information in various areas, information on corruption are generally unavailable or just partly available, and they are often, like other information of public interest, hidden from public. Potential whistleblowers may be persons who possess information on unknown facts and events that are practically usefull for reporting corruption and useful for governing institutions competent to fight against corruption, and are usually available to employed persons. Access to personal data of whistleblowers may be misused for violation of privacy. The subject of this analyses is the possibility of protecting these data and hiding the identity of whistleblower, as issues where advantages and disadvantages of the use of information technologies are being intersected. Discussion on what may be the advantages and disadvantages of the use of information technology in the whistleblowing process is wide and may entail a lot of other issues, like for example, those relating to: intercommunication between whistleblowers and governing institutions; cooperation and association of whistleblowers in order that they jointly act towards the governing institutions and media, starting from local to international level; removing and reducing the consequences of inadequate protection of personal data (confidentiality) such as lack of adequate legal regulations or non-implementation of legal provisions in force; regular follow up of

whistleblower's protection, by governing institutions or whistleblowers' associations, etc. The paper starts from the main thesis that the use of information technologies enables for the efficient protection of the whistleblower's identity, and special thesis: the use of these technologies does not question the rule that the protection of personal data of whistleblowers (confidentiality) is irreplacable way of protecting the identity and has advantages comparing to hiding of whistleblower identity (anonimity); the success in the fight against corruption and other violations of public interest depends at the same time upon the reliability of the protection of personal data and reliability of the protection of identity: duty of subjects in charge of receiving the reports on corruption is to act upon every report and information submitted in good faith (bona fide) is the grounds for the use of these technologies for anonimous whistleblowing; possibility of communicating to whistleblower whose identity is hidden with the competent officials is an important prerequisite for the growing use of these technologies in protected whistleblowing.

2. THE SIGNIFICANCE OF INFORMATION TECHNOLOGIES IN THE WHISTLEBLOWING PROCESS

The information technologies are incitement for citizens to perform protected whistleblowing and make an important form of legally driven fight against corruption and other violations of public interest, by enabling the submission of reports in various ways, including the hiding of identity. The protection of identity of whistleblower, meaning the availability of personal data of whistleblowers only to authorised subjects (confidentiality) or hiding of these data so that they are not known, is a way of increasing the nubmer of reported, investigated and prevented illegal and harmful acts (anonimity). The subject matter of the protection are personal data of employee, or worker, that may be exposed to harmful acts, and especially to discrimination on the grounds of his submitting a report or informing the public on corruption or other violation of public interest by the employee, or the protection of personal data of person who is not employed nor otherwise worker, who submitted a report against the perpetrator of the corruption or informed the public about the corruption or other kind of violation of public interest. Whistleblowing may also include personal data of other persons, for example witnesses and persons against whom the report is being submitted. The confidentiality means that the identity of whistleblower is known only to authorized subjects and persons and unknown to other subjects and persons, except in cases provided by law, when this rule may not have to be obeyed. Anonymous whistleblowing is such a form of whistleblowing where the identity of whistleblower is not known even to person competent to receive the report on corruption and other unethical acts. (Stephenson, 2012, p. 7) The anonimous whistleblower reports about certain act, and by doing so, he does not reveal either his name, or other personal data. If that is done with the use of IT, it is also neccessary that other indirect clues to identity are not present such as the http address. If whistleblowing is done by phone, automatic recognition of the phone number should be disabled. If information technologies are being used starting from online platforms for corruption reporting, to the smartphone applications, hotline calls etc, at anonimous reporting, apart from hiding the identity it is possible to submit information and proofs in anonimity. Therefore, it appears justified to define the ways according to which the whistleblowers are giving possibility to report, which have to be clearly specified, and they primarly relate to the flollowing: to report in good faith, in general interest, and proceedures must be clearly and completely defined. If the said conditions for the protection of persons reporting corruption or other kind of violation of public interest are set by law, then in principle, the role of subject who protects these rights in accordance with law, comes down to determination whether these conditions were fulfilled, and the subject does not have a discretionary power to decide whether that person has a right to be protected. Such an approach towards the protection of whistleblower enables for the

whistleblowing to be an alternative to silence, but also for the information technologies to be increasingly used for confidential and less for anonimous whistleblowing, as it was described above.

The use of information technologies and the choise of the type of whistleblowing (internal, external or reporting to public) significantly impacts the possibility of the protection of whistleblowers identity. Internal and external whistleblowing is usually tied to the confidentiality of personal data or hiding of identity of whistleblower, and informing the public is tied with information about personal data. Anonimous whistleblowing is also provided for in the UN Convention against Corruption (Article 13). Informing the public means revealing the relevant data to public information system, or through them, with the use of internet, or other tools, informing the public. At open whistleblowing, the whistleblower is aware and accepts the public to know about the information on his identity, and it is a pertinent part of open whistleblowing. The use of information technologies enables submission of reports in various ways (platforms, hotline calls, smartphone applications). Speaking of this type of whistleblowing, a new media organization is being created, the example of which is WikiLeaks (Brown, 2014, p. 250). We may put a question of how the information technologies may replace the identity protection at the confidential whistleblowing, and what are the advantages and disadvantages of anonimous whistleblowing comparing to confidential whistleblowing. The social influence of information technologies are beyond any doubt, when whistleblowing process is at issue. Whistleblowers may rather chose to whistleblow in anonimous manner through other chanells then those provided by whistleblowing legislative. The phenomenon of web pages such as WikiLeaks, AdLeaks and other enables the existencs of such chanells. What can have a negative effect to potential whistleblowers is the proliferation of surveillance technology and retention of Internet protocol data records, which goes paralelly with the technology of online reporting. Even mere connecting to certain Website may lay suspicion, which will lead to whistleblowers being very cautious. One of the solutions may be the above mentioned TOR system (Roth, 2013, p. 354). Anonymous expression has a long tradition in reporting such as whistleblowing. Anonymity on internet is considered as a part of freedom of expression (Benedek, 2012). That is also confirmed by Special Rapporteur on Freedom of Opinion and Expression report of 2011. Flaws in the protection of whistleblowers and the simple way of uploading electronic documents, led to increase of use of online platforms through which whistleblowers may publish information anonymously. Having in mind that the internet has a global sphere, those information remain available online, with very limited possibilities of erasing them (Čošabić, 2015). There emerge platforms such as WikiLeaks, which is the most known one, but also such as Globalleaks and Associated Whistleblowing Press, as well as AfriLeaks. These platforms are not professional media platforms but support the development of research journalism. Guardian has set a platform by which users are enabled to upload report on whistleblowing directly, and at the same time they are protected by TOR, and Guardian ensures not to use their IP address, set cookies, follow sources etc. Guardian has also dealt with the issue of contacting the whistleblower back after submission of report[1]. AdLeaks which is supported by Freie Universität Berlin and The City University of New York, is a platform which supports free online whistleblowing. However, disadvantage of online whistleblowing is the increase of techniques of surveillance and keeping of internet protocol data, which may have an unfavorable effect for potential

[1] That is done by allocating the whistleblower a unique code name, so that writer or editor may leave a message through SecureDrop system. In that way the whistleblower may be reached, and he may access the system only by his code name, https://securedrop.theguardian.com/

whistleblowers, which leads to even the mere act of connecting with an online website for whistleblowing raising suspicions.[2]

This is especially important when corporate or official corruption is at stake, which is sometimes very difficult to be revealed without the insider i.e. whistleblower. Notwithstanding the fact that many countries have issued laws which protect revelation of information by whistleblowers, still potential whistleblowers sometimes face fear from discrimination and retaliation, and rather opt for anonymous whistleblowing through channels which are not provided by whistleblowers' legislation (Roth, 2013, p. 1).

The greatest difference between online and offline reporting is the easiness of documents uploading, publishing and disseminating, at online whistleblowing. Before the emergence of internet and whistleblowing platforms, a whistleblower had to find media, i.e. newspapers and a journalist who would eventually protect their identity. It was very hard to ensure the anonymity, and if the government would discover that the information has reached the media, they could impose and injunction on the publisher even before the publishing itself. Even if the information was published and the anonymity was provided, dissemination of the information is not guaranteed. WikiLeaks faced with temporary disruptions in online reporting due to "denial of service" attacks, and they decided to put their website at Amazon servers. However, Amazon refused setting the website on its servers being pressured by the authorities (Lozano, 2010). Hotline as a mode of reporting is also popular, provided that recognition voice techniques are disabled. Company Siemens in Germany provides a hotline for reporting irregularities in work. In that way, they strive to fight against any irregularities in their work, asking for support from their workers in that, which places them at the top of most attractive employers in Germany. Hotline may be more simple to install then online platforms, and always at hand to users, (requiring only phone) but is also less detailed and does not provide for document upload, etc. Smartphone applications are recently being more and more used for anonymous reporting with the view of collective intelligence, for example for collection of information on pollution in cities, but also for submitting information on corruption which enables the creation of map incidence of corruption. The advantages of the use of IT are that whistleblowers may collect and spread information very easily and they do not have to do that through third person (for example, the reporter/journalist). IT gives greater connectivity and discussion upon information either on closed forums or publicly (blogs), long distance connection with trusted journalists (Brown, 2014, p. 254).

There is uncertainty that if the illegal speech is put under the veil of anonymity, the right to anonymity online as a part of freedom of expression may be threatened. Therefore the limitations of freedom of expression through anonymity must follow Article 10 of the European Convention (Benedek, 2013, p. 20). Accordingly, anonymity which is used for reporting unethical conduct and corruption must be differed from the anonymity used for such a speech that is not protected by freedom of expression, such as hate speech, call for doing criminal acts etc. We may distinguish two kinds of anonymous whistleblowing, one is whistleblowing that is inherent to workers, and another one is whistleblowing that is open and available for all citizens. If the whistleblowing is only provided for workers, then it is usually enabled through intranet page, or internal information system. Shortage of such a system may be that if the corruptive activities are wide spread, then the worker will sustain from reporting, either considering such activities as normal and usual, or being affected by such activity, so that if he has not yet been involved in that, he plans to do so. If the whistleblowing is open for everybody, through open online platforms, then it is more

[2] There are however technical ways of removing those problems, such as SSL connection to TOR network which hides the end user of the network. However, national investigation agencies may follow such connections as well. New way of submitting reports is AdLeaks which disables any tracing in online reporting.

comprehensive but also less direct, and there is a question of the source of information. At open or external whistleblowing through online platforms, a special place belongs to whistleblowing towards media, which is clearly influenced by information revolution. By this type of whistleblowing, a whistleblower is enabled to submit report on corruption or other unethical conduct to media directly, and there is even a possibility for an editor to contact back the anonymous whistleblower, through certain code, in order to gain more information. Thus, some police offices in Germany (for example in Lower Saxony) and the European Anti-Fraud Office (OLAF) use systems for reporting that apply technological measures of protection for keeping anonymity of whistleblowers, allowing them at the same time to get into contact with investigators. Nobody within the police nor outside of it can reveal the identity of person who decided to remain anonymous. This functions as a 'blind' post box in which both parties leave their messages (Stephenson). This is important in order that a person who anonymously submitted a report on corruption, but whose identity is revealed, may ask for a protection from harmful acts or threats that such acts will be done towards him, having in mind that he could reveal that he is an anonymous whistleblower. As an important form of informing public on retaliation and harmful acts to which whistleblowers are exposed individually and as a social group, we may point out a webpage which is intended for the affirmation of whistleblowing and protection of whistleblowers. That is a way that associations and other non governmental organizations that gather whistleblowers regularly or temporarily inform the public on problems and possibilities of protection of whistleblowers exposed to harmful acts and retaliation.

3. ROLE OF INFORMATION TECHNOLOGIES IN PREVENTION OF RETALIATION AT OPEN WHISTLEBLOWING

Information technologies are being increasingly used for protected reporting of corruption and o the violations of public interest, but providing for the protection of whistleblowers in posttransitional countries of Southeastern Europe does not follow these changes. The analyzed laws on the whistleblowers protection in Bosnia and Herzegovina, Montenegro, Serbia and Croatia do not contain provisions on the use of information technologies by whistleblowers, nor by subjects that are obliged to react in case of protected whistleblowing and subjects that have to protect the whistleblowers rights, except for the possibility of submitting a report on corruption via internet. Therefore, the possibility of hiding the identity of whistleblower depends on the mode of regulation of obligations of subjects and persons competent to act upon report or information, and is based on their duty to act upon the anonimous reports or information. If the law prescribes that they are obliged to act upon anonimous reports and information, or if there is established praxis for doing so, no matter that such a duty is not prescribed by law, then there is a possibility for using information technologies in a way that the identity of whistleblower is hidden. Whistleblower then may use information technologies according to rules applicable to submitting a report and protection of rights of whistleblower. In the analyzed laws, the content and scope of the protected rights of whistleblowers does not depend on whether it is an internal, external whistleblowing at issue, whether it is anonymous or confidential whistleblowing or the identity of whistleblower is known to the public. In this case these rules are a legal framework for the use of information technologies within social aims, among which the fight against corruption in public and private sector and developing social and individual responsibility for participation in that fight as well as supporting the whistleblower, including support to employed whistleblower by other employees working at the same employer and their collective representatives (trade unions and workers councils) are the most prominent (Mirjanic, 2016, p. 797).

The analyzed laws on the whistleblowers protection, provide for the protection of confidentiality of personal data and for the possibility of anonymous whistleblowing. The anonymous whistleblowing is recognized in the comparative legislature on whistleblowing and whistleblowers protection, and the example for that may by that in the USA, Sarbanes Oxley Act determines special provisions in order that persons could raise suspicions in anonymity (Stephenson, 2012, p. 3). The analyses of the laws shows that the protection of personal data of whistleblowers by subjects authorized to deal upon the report or information on corruption is a main way to protect the identity of a whistleblower. Confidential whistleblowing presumes the submission of report on corruption and other unethical acts to competent persons, who know the identity of whistleblower, but carry out measures in order that his identity remains confidential for public. In that case, the adequate legal protection is necessary, and it includes the procedure of confidential whistleblowing, determining the circle of persons who know the whistleblower's identity and the mode of ensuring that the identity is not disposed to public. Regarding this type of whistleblowing, it is very important that there are clear legal procedures in place, but also that such legal procedures are being respected, and that impartial persons and bodies receive the reports on corruption and other unethical behavior, amongst whom such unethical and corruptive behavior does not exist. Accordingly, professionalism in acting of officials competent to receive such reports is needed, especially when media are being informed. Media representatives are also obliged, even if they find out about the whistleblower's identity, not to reveal that identity to public. So, the confidential whistleblowing requires a systematic approach and legal protection as well as implementation of that protection in praxis. There can always be a question of adequate legal protection of whistleblowers on one hand, and what is more important adequate implementation of law in a society where corruption is significantly present, on the other hand. In such societies, a potential whistleblower, upon getting to know about unethical acts, has to overcome another obstacle in order to do reporting, and that is his fear from retaliation. If his fear is greater then the expected society benefit of reporting, he will sustain from reporting. The more present corruption and unethical acts in a society, the bigger the obstacle in the eyes of potential whistleblower. Even if the legal protection of whistleblowers from retaliation is very well regulated by law, there remains very important question of implementation of such laws. Are there impartial implementing organs? This entails the efficient judicial system which will include the protection of whistleblower in all segments of proceedings against the person that is reported by whistleblower, but also other bodies that are impartial and resistant to corruption, starting from bodies receiving reports on corruption, police, etc.. The importance of the implementation of legal provisions in praxis is supported by the results of research according to which the whistleblowing in Southeastern Europe has a relatively weak support by the citizens, since just more then a half of examinees from the whole region considers that whistleblowers should be supported. One third out of 7000 examinees from the region of Southeastern Europe said that the whistleblowing is acceptable in their society, while one out of six examinees considers that whistleblowers should be punished for their acts, as stated in the report of the Regional Cooperation Council about citizens attitudes about revealing the corruption and crime.

The advantage is given to the protection of personal data of whistleblowers, apart from the likelyness that whistleblowers shall more and more opt for whistleblowing in which their identity is hiden, being influenced by the expansion of information technologies. Confidential whistleblowing leaves for a possibility that whistleblower is contacted again by competent authorities and that other necessary details for investigation are sought. For such type of whistleblowing it is considered that in order that a whistleblower is protected, it is necessary that his identity is known. On the other hand, the possibility of anonymous whistleblowing lowers the threshold for potential whistleblowers to go out with their reporting, so they would

rather decide to whistle blow if they are anonymous. Confidentiality is protected by laws, so this protection in certain states is very high. In USA for example, it is forbidden to reveal identity of whistleblower without his consent, while India prescribed even imprisonment and fine for revealing whistleblower's identity. Anonymity is a strong way to protect whistleblowers, but still some laws do not allow for anonymous reporting due to its inadequacy for investigation proceedings, or due to impossibility to initiate criminal proceedings on the grounds of anonymous whistleblowing. Anonimous whistleblowing may compensate for the imperfections of legal system, which are either in form of legislation flaws, or in implementation of law flaws, or in inadequate organisation of body receiving reports. The anonimity of employed whistleblower must be protected unless he agrees to revelation of his identity. It may be considered that complete protection of employed whistleblower from retaliation is unlikely to happen unless his identity is completely anonimous. It is important that the whistleblower's identity remains confidential as longer as possible. In a principle, whistleblowing act is seen by collegues and superiors as an act of disloyalty. Companies should allow employees to report through several methods indlucing e-mail, internet, hotline and letters. If there is lack of guarantee of identity protection, potential whistleblowers would be reluctant to decide to whistleblow (Lipman, 2012).

4. CONCLUSION

There is a significant social influence of information technologies when process of whistleblowing is concerned. The protection of the identity of whistleblowers with the help of these technologies is an important prerequisite for further development of the protected whistleblowing. Disadvantages of anonymous whistleblowing are twofold. First, there are technical disadvantages which may lead to indirect revelation of identity of whistleblowers, within the highly developed information technologies which may be inherent to governmental bodies. On the other hand, there may be substantial disadvantages in case when it is not possible to contact the whistleblower in order to obtain more thorough information, and disadvantages of legal nature, when many national criminal legislatures do not allow for the use of anonymous reporting as evidence in criminal proceedings. The first two may be eliminated: through available free services of protection against tracing, and the protected contact with whistleblowers. The third disadvantage, legal one, is related to legislative system of each country and may be overcome so that the whistleblowing report could be used just as an incentive to for other evidences.

The advantages of anonymous whistleblowing using IT are numerous, starting from removing psychological barriers of whistleblowers when deciding to whistleblow, to using secure anonymous channels, especially in cases where there is a fear from insufficient legal or practical protection of confidential whistleblowing. These advantages, especially from the aspect of countries in a posttransitional period of Southeastern Europe, may present an important reason when deciding to enable anonymous online whistleblowing.

LITERATURE:

1. Benedek, W., Kettemann, M.C., (2012). *Freedom of expression and the Internet:* Strasbourg, Council of Europe
2. Brown, A.J., Lewis, D., Moberly, R., Vandekerckhove, W. (2014). *International Handbook on Whistleblowing Research.* Edward Elgar Publishing Limited, UK
3. Čošabić, J. (2015). *Territorial Implications of the 'Right to Be Forgotten'*: New York, Psychosociological Issues in Human Resource Management 3(2): 53–64.
4. Lipman, F. D., *Whistleblowers: Incentives, Disincentives, and Protection Strategies* (2012). John Wiley & Sons, Inc., Hoboken, New Jersey

5. Lozano, E., Joyce, A., Schiemann, R., Ting, A., Yahyavi, D. (2010) *Wikileaks & Whistleblowing, Digital Information leakage and its impact on society*, http://cs.stanford.edu/people/eroberts/cs201/projects/2010-11/WikiLeaks/index-2.html
6. Mirjanic, Z., Cosabic, J. (2016). *Protection of Whistleblower's Employment Status:* Split, 16th International Scientific Conference on Economic and Social Development, The Legal Challenges of Modern World, 1-2 September 2016
7. Mirjanic Z., (2016). *Role of Social Partners in Protecting an Employed Whistleblower as an Element of Social Development*: Zagreb, 18th International Scientific Conference on Economic and Social Development – "Building Resilient Society" – Zagreb, Croatia, 9-10 December 2016
8. Roth, V., Güldenring, B., Rieffel, E., Dietrich, S., Ries, L. (2013). *A Secure Submission System for Online Whistleblowing Platforms*, Financial Cryptography and Data Security: 17th International Conference, FC 2013, Okinawa, Japan, April 2013: edited by Ahmad-Reza Sadeghi, Springer
9. Stephenson, P., (2012). *Whistleblower protection- a comparative analysis*, a Study for the Commissioner for Information of Public Importance and Personal Data Protection of Serbia
10. Study on Whistleblower Protection Frameworks, Compendium of Best Practices and Guiding Principles for Legislation, G20 Anti-Corruption Action Plan Protection of Whistleblowers; (Protection of sources-zaštita izvora http://www.ohchr.org/Documents/Issues/Opinion/Protection/AssociationProgressiveCommunications.pdf
11. Zakon o zaštiti lica koja prijavljuju korupciju u institucijama Bosne i Hercegovine.
12. Službeni glasnik Bosne i Hercegovine br.100/13
13. Zakon o zaštiti uzbunjivača. Sluņbeni glasnik Republike Srbije, br. 128/2014.
14. Zakon o sprječavanju korupcije. Sluņbeni list Crne Gore, br.53/14.
15. Zakon o radu. Narodne novine Republike Hrvatske br. 93/14.
16. 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.
17. https://www.apc.org/node/5677 Internet Charter, access for all, 3.3. Leak Platforms
18. https://www.oecd.org/g20/topics/anti-corruption/48972967.pdf
19. http://www.rcc.int/

HARMONISATION OF RETENTION OF TITLE

Zrinka Radic
Municipal Court of Split, Croatia
zrinka.radic@osst.pravosudje.hr

ABSTRACT

The modern market economy is inconceivable without credit. Retention of title is non–possessory security rights in movable property specializing in one type of contractual relationship of credit - buying goods on credit or installments. Introductory remarks define the concept of retention of title and position of this institute in the system of the non–possessory security rights in movable property. Article analyzes the application of this institute in the EU Member States, representatives of the continental civil law, the common law and countries in transition. The purpose of the analysis is to determine: a) the problems of international trade due to different regulation of this legal institute in national legislation, b) the existence of similar solutions in relation to fundamental aspects of this institute despite the diversity of legal systems. Article then critically examines the legal sources of retention of title in European Union law and the failure of the European Union to create a European retention of title or to harmonize this legal institution in the European Union, despite attempts to do it in a period of more than thirty years. Article especially considers the existing regulation in comparison with the recommendations of the UNCITRAL Legislative Guide on Secured Transactions, Draft Common Frame of Reference for European Private Law (DFCR) and Model law on security transaction EBRD and makes proposals for their improvement de lege ferenda. At the center of the attention is the issue of harmonization of this institute, and thus determining the direction of further harmonization of non–possessory security rights in movable property.

Keywords: *movable property, non–possessory security rights, pactum reservatii dominii, private law, retention of title*

1. INTRODUCTION

Retention of title (*pactum reserve dominii*) is a secured transaction well known since Roman law. It is a contract clause on the basis of the seller adheres to the right of ownership of the sold item even after it has been handed over to the buyer, usually until the full payment of the price (Romac, 1992, p. 313). Ownership is transferred with the condition of delayed full payment of the price. Placing this clause is usually the case with the sale of goods to a credit or for sale with a payment in installments. Intensive application of this institute in business practice began after the First World War. Initially it was used in purchase on installments and later became a secured transaction of commodity credits (Barbić, 1970,p.135-136). Economic importance of retention of title today is extremely important. It is usually contracted among large business entities in the purchase of various commodities, especially industrial equipment, and raw materials. Retained ownership secures the seller's claim as he remains the owner until full payment of the purchase price. The buyer gets possession of goods before he has pay fully the purchase price. This makes it easier for the seller to place his goods on the market. The buyer gets the commodities for production, because he does not have to pay them immediately and by working with those commodities it's easier to acquire money to settle the loan. (Ernst, 2006, p. 57). Retention of title is a form of secured transactions' regime that is based on ownership conception (ownership is retained on own goods). On the other hand, security right is a deposit of debtor's personal property to a creditor.

2. MEMBER STATES OF THE EUROPEAN UNION

2.1. Germany

The German is a representative of the German legal circle which has developed secured transactions' regime based on the property regime. Hence retention of title is the most typical secured transactions' for German law.

Retention of title is stated in § 449 *Bürgerliches Gesetzbuch* (BGB): *„Hat sich der Verkäufer einer beweglichen Sache das Eigentum bis zur Zahlung des Kaufpreises vorbehalten, so ist im Zweifel anzunehmen, dass das Eigentum unter der aufschiebenden Bedingung vollständiger Zahlung des Kaufpreises übertragen wird*." - If the seller of a movable property reserved the property until the payment of the purchase price, it is to be assumed in the doubt that the property is transferred under the suspensive condition of full payment of the purchase price.

The German law constructed a retention of title as a transfer of ownership under a suspensive condition. If the buyer fulfills the condition mentioned in the retention of title clause he will become the owner. Before fulfillment of this condition he holds an *Antwartschaftsrecht*. This is the specific subjective right of the buyer - the right to wait to become the owner. That right is transferable, pledged and compelling. The seller, on the other hand, remains the owner of the good under a suspensive condition. He will lose his ownership if the condition is fulfilled. The seller and the buyer may agree on the retention of title without special form in the contract of sale. The latest moment retention of title clause can be agreed upon is just before the delivery of goods. (Vijn, 2013, p. 156). Registration is not required. Apart from the simple retention of the title (*Einfacher Eigentumsvorbehalt*) German law has also developed complex structures of retention of the title. These are:

a) extended retention of the title (*Verlängerter Eigentumsvorbehalt)* which aims to enable insurance of the purchase price in the process or re-purchase of the purchased item. In this way, retention of title metaphorically extends vertically to subrogation of retention of title. This form of retention of title holds great economic significance.

b) the expanded retention of the title (*Der erweiterte Eigentumsvorbehalt*) which is metaphorically horizontally extended to other claims, not just the payment of the purchase. This can be all existing and future claims between the contracting parties *(kontokorrentvorbehalt*). Such retention of title usually contracts with long-term business relationships in trade (Kindl, p. 477–488).

In case of insolvency and enforcement, simple retention of title is treated as exclusion right and complex forms as the separate satisfaction (discharge) right (Ernst, 2011, p. 466-467, 470, 475).

2.2. France

France is representative of the Roman legal circle that has developed a secured transactions' regime with a non-possessory registered pledge. Therefore, with regard to industrial equipment, retention of title was replaced by the non-possessory registered pledge (Barbić, 1970, p. 145). Business practice and law doctrine have developed this institute. However, the retention of title clause could not be invoked in the case of buyer's insolvency. That was the reason for the poor use of this institute in practice. This changed in 1980 when the French legislator determined that a retention of title clause could also be invoked in the buyer's insolvency. Ordonnance No. 2006-346 of March 23, 2006. France has carried out a reform of its secured transactions' regime. Art. 2367 - 2372 Civil Code (CC) French legislator has introduced the *réserve de propriété* into its legal system. Chapter IV of Book IV of the CC deals with secured transactions. The definition of retention of title is in article 2367 CC: *La propriété d'un bien peut être retenue en garantie par l'effet d'une clause de réserve de propriété qui suspend l'effet translatif d'un contrat jusqu'au complet paiement de*

l'obligation qui en constitue la contrepartie. La propriété ainsi réservée est l'accessoire de la créance dont elle garantit le paiement"- Ownership of goods may be retained as security through a clause of retention of title which stays the transferring effect of a contract until full payment of the obligation which compensates for it. Retained title is the accessory of the debt whose payment it secures'. The ownership thus reserved is the accessory of the claim whose payment it guarantees. In France the ownership of a good is transferred at the moment of the conclusion of the contract. That provision is *ius dispositivum* and therefore parties can agree otherwise. The retention of title clause has to be agreed on in writing. (Vijn, 2013, p. 157).
For effects *erga omnes* retention of title registration is not required. In the case of a debtor's delay outside the bankruptcy, the creditor may demand repossession of goods to reestablish the right of disposal. There is no contract termination. This is not in compliance with the ownership concept of the retention of title. In the insolvency there is also *rei vindicatio* request. This construction is closer to the idea of a pledge than to ownership. French law does not know the complex forms of retention of title as German and English law (Ernst, 2011, p. 500-503).

2.3 England

England as a representative of the common law legal system also knows retention of title. Parties can agree that the transfer will be subject to the payment of the purchase price. Retention of title is stated in 19 Sale of Goods Act 1979:"*Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled; and in such a case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee or custodier for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled*."
An English variant of retention of title is called *Romalpa* or ROT clause. The original case that gave name to these clauses is Aluminum Industrie Vaassen B.V. Romalpa Aluminum Ltd. (See more on this: Aluminium Industrie Vaassen B.V. v. Romalpa Aluminium Ltd. [1976] 1 WLR 676; Wolff, L-C., 2014, p. 19.; Davies, 2006, p. 3-4; Sparrow, R., 2013). This case gave three new insights about retention of title in England: 1) the operation of retention of title was shifted from the consumer context to the commercial context, 2) the seller did not merely reserve title whilst the goods were in the possession of a third party, but he reserved title even though the goods were already in the possession of the buyer, 3) the case illustrated that retention of title could also be used for commodities, raw materials and other less durable personal property (Vijn, 2013, p. 158).
ROT clauses may be categorized into three different types:
1. a "simple" clause - the seller seeks to retain title only to those unchanged goods supplied under the contract that have not yet been paid for
2. a "product" or "manufacture" clause - the seller retains title to the goods even after they have undergone a manufacturing process (the seller permits the buyer to use the material together with other materials either owned by the buyer or by a third party to product a new item with the seller seeking to establish rights to the new item or rights to the proceeds of sale of the new item)
3. a "proceeds" clauses includes purchase price, namely:
   - an "all monies" or all "accounts" clause - title is retained to all goods supplied by the seller including those that have been paid for until the buyer has paid all monies owed to the seller for the entirety of the goods supplied

- a “proceeds of sale” clause - the seller permits the buyer to sub-sell the material supplied with the seller seeking to establish rights to the proceeds of those sales (Davies, 2006, p. 4; Ernst, 2011, p. 477-487).

The owner that retained the right of ownership in insolvency and enforcement has the exclusion right (Povlakić, 2001, p. 225).

2.4 Countries in transition

2.4.1 Central and southeast Europe

The insurance of claims in the former socialist countries at the time of socialist social order lost its economic significance. Because of the state ownership, the planned economy and the state monopoly on banks, there was no real market economy or demand for loans. In the early 1990s, social and economic circumstances changed, i.e. the emergence of a modern market economy occurred in these countries. It required an efficient and easily accessible lending system. Due to the lack of a unique European law, non–possessory secured transactions in movable property and various national legislation, the process of transition of the legal system of Central and Southeastern Europe was influenced by the wider international community. As a model for drafting national regulations, the European Bank for Reconstruction and Development 1994 issued the Model Law on Security Transaction EBRD. It was a compilation of the US *security interest* and the English *floating charge*. It was therefore not adapted to the continental system of secured transactions on movable property. The consequence of such work was the departure from continental legislation in the countries of Central and Eastern Europe. Thus in Southeast Europe an attempt was made to unify secured transactions on movable property under the transplanted Art. 9 UCC (Jessel-Holst, 2003, pp. 80-81). Countries in transition mostly decided to combine more models of non-possessory security rights in movables. However, retention of titles in transition countries is generally not accepted as a form of secured transactions regime. The exception is Estonia, which is regulated by the institute in accordance with German law, but is rarely applied in practice (Jessel-Holst, 2003, p. 75). This institute also exists in Czech commercial and civil law, but with a scarce legal regulation (Povlakić, 2001, p. 40).

2.4.2. Croatia

Croatia is a transitional country. After leaving socialist legal circles and after the acceptance of market economy reforms, Croatia implemented its own system of security rights.

The Croatian legislator decided on the plurality of non-possessory security rights in movable property with a view of reintegration into a continental European legal circle. Due to its economic importance, retention of title was known in Croatian business practice before, during and after the socialist legal circle.

During the application of the General Civil Code (OGZ) 1852, § 1063 indirectly regulated the retention of title. On the basis of the OGZ, this institute was developed by business and court practice (Rušnov, Posirović, 1911, p. 449-450). In the period after World War I doubts appeared about the admissibility of retention of title with respect to the social ownership of companies and real estates. But due to the economic significance of this institute, its application was recognized by jurisprudence and legal theory (Barbić, 1970, p. 168-169).

During the period of the socialist legal circle the retention of title on movable property was governed by the Act on Obligatory Rights 1978 (ZOO/78), in which Art. 540 regulated the purchase with retention of title. No special form is required for validity of clause of retention of title. For the effects of *erga omnes* the retention of title should be in the form of a publicly verified document. After leaving the socialist legal circle, the retention of title from ZOO/78 has been taken over by the applicable Act on Obligatory Rights 2005 (ZOO) - Art. 462.

Unlike the ZOO/78 which limits the contracting retention of title only on movables, in ZOO there is no such limitation. Hence, retention of title can be contracted on real estate as well. Retention of title is possible on movable property on both individual and generic goods (Gorenc et al., 2014, p. 795). The ZOO has determined the legal nature of the retention of title by prescribing that the property is transferred under the suspensive condition of full payment of the price (Art. 462, par. 2). The ZOO regulated retention of title similarly to German BGB, although Croatian law does not accept German *Trennungsprinzip*. Hence ownership transfer is resolved at the level of substantive law, not as conditionality of a substantive law contract (not recognized in Croatian law), but instead as restriction of ownership right. - Art. 34 of the Law on Ownership and Other Rights *in rem* (ZV). Despite the fact that the theory borrows German doctrinal concept of *„the right of waiting" (Anwartschaftsrecht),* Croatian court practice does not recognize this interpretation. ZOO recognizes the rules on retroactive effect of fulfillment of suspended conditions which has been rejected in German property law (Ernst, 2010, p. 172-173; Gavella et al., 2007, p. 557).
The Act on the Registry of non-security in movable property regulates only the registration of the retention of title if its duration exceeds one year (Art. 6 ZU). This ensures the required publicity of only long-term, but not short-term loans.
The ZOO does not regulate the settlement method of retention of title. Legal theory holds that the owner who retained ownership over security may be satisfied under rules of out-of-court enforcement of security rights. (Art. 337 ZV). That is partially functional approach to security over movables (Art. 297, par. 2 ZV and Art 34. par. 5 ZV). The application of the security rights is not in accordance with the nature of the retention of title. It is unlikely that a buyer will be found who will buy a good from the owner, who is unable to transfer possess of good. Such a manner of solving of retention of title is complicated and impractical (Mihelčić, 2014, p. 222-234). American law has re-characterizated retention of title to a security rights by a functional approach. But, it still respects the ownership concept of retention of title by superpriority irrespective of the fact that the retention of title was created later - *acquisition security rights.* In case of insolvency, Croatian law applies the rules of out-of-court enforcement of security rights without the rules of acquisition rights. Such reparation is contrary to the legal nature of retention of title. On the other hand, in insolvency the owner who retained ownership over security the retention of title is recognized as an exclusion right. That is respecting the ownership right of the retention of title. Such a settlement of insolvency and out of insolvency is a half-baked solution and stumbling block to keep retention of title an effective and well-accepted secured transactions.

2.4.3 Bosnia and Herzegovina (BiH)

BiH is transitional country like Croatia. However, unlike Croatia, which became an EU member in 2013, BiH has launched the EU accession process in 2016. During its affiliation with the same state, BiH regulated retention of title the same way as Croatia. After independence, BiH has carried out a reform of non-possessory security transactions' regime by adopting the Framework Law of security rights in Bosnia and Herzegovina in 2004. However, the retention of title in the unchanged form is taken over in the Act on Obligatory Rights of the Federation of BiH. The only newspaper is the introduction of a registration obligation with declarative and publicity effect (Povlakić, 2010, p. 312-313).

3. ATTEMPTS AT HARMONISATION OR UNIFICATION

3.1. Generally

Due to the needs of international trade, the 1953 United Nations Economic Commission for Europe (UN/ECE) stipulated that the parties may contract clause of retention of title provided that it is permitted under the law of the country in which factory or equipment is located after

the delivery. The purpose of negotiating a clause on the ownership right is to protect the seller from the time the buyer gets the goods in possession or when the goods are outside the exporting country (Barbić, 1970, p. 137). However, the difference between individual national systems in this institute and other forms of non-possessory security rights is an obstacle to international trade. A particular problem is the difference between strictly formal and liberal national systems. Hence, the idea of harmonization or even unification of this part of secured transactions' regime is accepted.

3.2. Uncitral and Unidroit

At the end of the 1970s, the United Nations Commission on International Trade Law - UNCITRAL and The International Institute for the Unification of Private Law - UNIDROIT began work on trying to harmonize or even unify non-possessory security rights on movables around the world. The results of this paper are numerous international documents such as: Cape Town Convention on International Interests in Mobile Equipment 2001 and Protocol on Matters Specific to Aircraft Equipment 2001, Protocol on Matters to Specific Railway Rolling Stock 2007, The United Nations Convention on Assignment Of UNCITRAL Insolvency Guide 2004, UNCITRAL Legislation Guide on Secured Transactions 2007. The common feature of all these documents is the harmonization under the influence of american law, which is based on the functional approach to secured transactions. UNCITRAL Legislative Guide on Secured Transactions advocates a functional approach under which state laws of secured transactions' regime should cover all forms of secured transactions on movable property, including the retention of title. A functional approach concerning the retention of title can be implemented so that this type of secured transactions is regulated within the general regime for secured transactions ("unitary approach") or as a special type of secured transactions within the general secured transactions' regime having a functionally equivalent effect like other forms of security rights, thus ensuring equal treatment ("non-unitary approach"). In the context of a unitary approach, the concept of security rights includes secured transactions on the debtor's ownership and creditors ownership. The rights of all creditors who finance the purchase of goods in unitary approach are treated as special, priority rights - *acquisition security rights*. In the context of a non-unitary approach, this term does not include the retention of title. A non-unitary (double) approach allows states that wish to continue to maintain the system of retention of title over security, but to enrich it with new acquisitions of security rights. Such states can predict two parallel systems - the seller may, per his choice, choose retention of title or may, for his own benefit, establish an acquisition security rights, as envisaged in the unitary system. The UNCITRAL Insolvency Guide advocates "unitary approach". For countries where retention of title is regulated separately from other security rights, UNCITRAL's Guide provides an alternative approach in Recommendation 202 - "non-unitary approach". The Guide considers that the acceptance of a "non-unitary approach" towards which creditors whose rights derive from the retention of title have the status of exclusive creditors is in opposition to the basic idea of insolvency proceedings and the latest trends of business continuation by restructuring the insolvency debtor. It is believed that such creditors have greater rights in insolvency proceedings at the expense of other creditors. Exclusive creditors can't be included in insolvency proceedings as opposed to separate satisfactions creditors. Therefore, the Guide is committed to accepting a "unitary system" i.e. the re-characterization of the retention of title in security rights. The UNCITRAL Insolvency Guide defines bankruptcy estate as all the assets on which the bankruptcy debtor has rights *in rem* under which the retention of title is maintained. Insolvency Guide considers that the recognition of an exclusion right may be detrimental to the continuation of the insolvency of debtor's business, rescheduling or selling a bankruptcy debtor as a whole.

3.3. European Union

In the European Union, on several occasions, the European Economic Community (EEC) has tried to resolve the burning problems due to the failure to recognize unbiased security transactions among member states. In 1973, a draft directive of non-possessory security transactions on movables and clauses providing for retention of title upon sale of movables was published. The idea was to create an obligation on the part of the Member States to recognize certain security transactions validly established in the country of origin and to give the secured party those rights which it would have as security rights to the law at the new *situs*. It was planned that such recognition and enforcement would be dependent on prior registration of the security transactions. But no agreement was reached regarding registration which is why the project was not implemented. The second attempt by the EEC Commission was in 1979/1980. This attempt was limited to a simple form of ownership right. The draft directive required the Member States to recognize retention of title validly created per the laws of other Member State provided it was agreed upon in writing not later than at the time of delivery of the goods. The Member States should grant the seller a right to *rei vindicate* the goods if the buyer became insolvent or if execution was made against the goods on behalf of a third-party creditor. The work on this project was interrupted in 1980 because the European Council had started an international convention on the recognition of retention of title. This attempt proved equally unsuccessful (Kieninger, 2004, p. 22). With the draft of the 1998 Directive on combating late payments in commercial transactions, the European Parliament and the EEC Commission have tried to achieve minimum coordination. That draft stipulated that Member States were obliged to recognize the retention of title that was agreed in writing at the latest when delivering the goods. The retention of title is also considered under the terms of the general terms of business as well as an annotation in the receipt. The proposal also regulated the issue of the seller's risk in case of non-payment of the price, while for other issues was the relevant national legislation (Povlakić, 2003, p. 227). The first drafts presented by the EEC Commission contained some substantive uniform rules on retention of title and its validity in insolvency. However, the European Council opposed any substantive rules in this area. The latest attempt to force Member States to at least guarantee the validity of the simple retention of title in insolvency is made in the context of the directive on delays. Therefore, in year 2000 was adopted Directive 2000/35/EC on combating late payments in commercial transactions. The Directive has been replaced by Directive 2011/7/EU on combating late payment in commercial transactions which in Art. 9. regulates the reservation of title in the same way as the previous Directive. Art. 9. those Directives regulate that the retention of title must be expressly agreed before delivery of the goods. The only thing that has been achieved by this directive is obligation of Member States to ensure that a simple retention of title must be recognized in each Member State. However, national legislation, with all its differences, is still relevant for retention of title. The effect *erga omnes* is not regulated, and the institute of European retention of title was not created. In the area of harmonization of international insolvency law the first draft of the Directive was presented by the EEC Commission. That directive provided for uniform rules on the retention of title and its validity in insolvency. The final adoption of the Council Regulation 1346/2000 of 29 May 2000 on insolvency proceedings is limited to rules which stipulate that if a insolvency proceeding has begun in a Member State, it may not affect the creditor's claims, including the retention of title on movable property which are located outside the country where the insolvency proceedings are open. The Draft Common Frame of Reference of a European Private Law (DCFR) in Book IX, established rules on security rights. The retention of title is partly regulated by the general regime of secured transaction, and partly autonomous. Retention of title devices are subject to the following rules on security rights, unless specifically provided otherwise (IX.-1:104). The holder of a retention of title device exercises

the rights under the retention of title device by termination of the contractual relationship (IX-7:301). In the case of retention of title devices the parties may not agree to exclude extra-judicial enforcement - IX.-7:103:(3). Predefault agreement on appropriation of encumbered assets does not apply to retention of title - IX.-7:105:(5). DCFR rules have been made under the influence of American law. Despite attempts over thirty years, the European Union has failed to try to create a European retention of title.

The aforementioned indicates that the European Union is aware of the problems of international trade due to the different arrangement of this secured transaction in certain national legislations, but it is unprepared to solve this burning problem by introducing the European retention of title. Harmonization is being sought through DCFR rules according to which member states show resistance.

4. CONCLUSION

The development of the market economy implies an increased demand for commodity credits, and hence the greater importance of this security deposit. Therefore, the EU has endeavoured to achieve harmonization of this institute by introducing European retention of title. The work on this idea was evidently stopped because of the conviction in legal theory that the American model is superior (see: Davies, 2006, p. 15-18). Therefore, the harmonization of secured transactions regimes to achieve the transplantation of Art. 9. UCC. Transplant Art. 9. UCC according to "unitary approach" means the re-characterization of the retention of title in the security rights. Transplant Art. 9. UCC according to a "non-unitary approach" is the middle way between respecting the ownership structure of the retention of title and their re-characterization in security rights. However, legal practice is traditionally prone to conservatism, for which "indigenous" norms, i.e. norms that are in line with a country's legal tradition, work better than "transplanted" norms. The retention of title in European countries has been known since Roman law. A brief analysis of the legal regulation of retention of title in three different European jurisdictions points to the following conclusions. Common law (English) and the German (German) and Roman (French) legal circles that subordinate continental European legal circles vary in historical development and dogmatic structure. However, despite the differences between these systems in terms of retention of title, there is the equivalence of the model. The contracting party's position is analogous, does not require a publication and is identical to the protection of the owner in relation to the customer's creditors. The difference is that German law gives preference to the security of the creditor, while French and England give priority to legal traffic (Povlakić, 2001, p. 228). Such national models could help to detect common denominators which would be an “intellectual key” for necessary harmonization. Hence, the continuation of the harmonization of retention of title or the creation of European reservation of title can result in the harmonization of this legal institute. Which allows uninterrupted trade in the internal European market. This analysis shows that this is a valuable and easily accessible measure. Namely, all European countries are aware of the retention of title, while the transition country is more inclined to introduce ownership rights. By adopting Directive 2011/7/EU, which obliges Member States to recognize the simple retention of ownership rights, the EU has shown that it does not want to waive the retention of title. When harmonizing, it is necessary to respect the ownership structure of the retention of title. Meaning of the retention of title is secured transactions based on the ownership and exclusion right in the insolvency. This would be based on indigenous norms, not transplanted art. 9. UCC according to which business practice shows resistance. In the law of the Croatia and BiH, the legal basis of this institute is more than modest. Therefore, the efficiency of this institute and its practical application are modest. It is necessary to regulate legally the key issues of retention of title: creation, publication, effects *erga omnes*.

An acceptable model of legal regulation needs to be looked into in the observed legal systems. Croatia and BiH are the most similar to German legal system. It is primarily necessary to regulate a simple retention of title. Complex forms of retention of title can be introduced in order to increase the competitiveness of the economy of Croatia and BiH.

LITERATURE:

1. Barbić, J. (1970). Pridržaj prava vlasništva kod prodaje investicione opreme, in Goldštajn, A., (redakcija), Opći uvjeti poslovanja u međunarodnoj i unutarnjoj trgovini. Zagreb: Informator. pp. 135-179.
2. Bürgerliches Gesetzbuch (BGB) from www.gesetze-im-internet.de/bgb/index.html
3. Cape Town Convention on International Interests in Mobile Equipment; a Protocol on Matters Specific to Aircraft Equipment; a Protocol on Matters to Specific Railway Rolling Stock from http://www.unidroit.org/english/conventions/mobile-equipment/main.htm
4. Civil Code (CC) from https://www.legifrance.gouv.fr/Traductions/en-English/Legifrance-translations
5. Council regulation 1346/2000 of 29 May 2000 on insolvency proceedings. OJ L 160 30/6/2000.
6. Davies W. (2006). Romalpa thirty years on – still an enigma?. Hertfordshire*:* Hertfordshire Law Journal 4(2). pp. 2-23. Retrived 15.05.2017. from https://www.herts.ac.uk/__data/assets/pdf_file/0007/38671/HLJ_V4I2_Davies.pdf
7. Directive 2000/35/EC on combating late payments in commercial transactions. OJ 2000 L 200/35, 2000/06/29.
8. Directive 2011/7/EU on combating late payment in commercial transactions. OJ 2011 L 48 od 2011/02/23.
9. Ernst, H., (2006). Pridržaj prava vlasništva, in Josipović, T., (opća redakcija), Zaštita vjerovnika – pravni, porezni i računovodstveni aspekti. Zagreb: Narodne novine. pp. 57-83.
10. Ernst, H. (2010). Bezposjedovna sredstva osiguranja na pokretnim stvarima u Republici Hrvatskoj in Civil Law Forum for South East Europe, Collection of studies and analyses First Regional Conference, Volume II. Cavtat: GTZ. pp. 169-190.
11. Ernst, H., (2011). Funkcionalizam u mobilijarnom osiguranju tražbina. Zagreb: Pravni fakultet sveučilišta u Zagrebu.
12. Gavella, N., Josipović, T., Gliha, I., Belaj, V., Stipković, Z. (2007). Stvarno pravo. Zagreb: Narodne novine.
13. Gorenc, V. et al. (2014). Komentar zakona o obveznim odnosima. Zagreb: Narodne novine.
14. Grbin, I. (1983). Reservation of title; Yugoslav domestic law in The Hague - Zagreb Colloquium on the law of international sales, Session V. Zagreb: Institute for international law and international relations of the Faculty of Law. pp. 1-27.
15. Jessel-Holst, C. (2003). Reform des Mobiliarsicherheitenrechts in Südosteuropa in Das Budapester Symposium Beiträge zur Reform des Sachenrechts in den Staanten Südosteuropas. Bremen: Herstellung - edition temmen. pp. 66-82.
16. Kieninger, E.-M. (2004). Introduction: security rights in movable property within the common market and the approach of the study in: Kieninger, E.-M. (ed.) Security Rights in Movable Property in European Private Law. Cambridge:Cambridge university press. pp.6-37.
17. Mihelčić, G., (2014). Namirenje tražbine osigurane pridržajem prava vlasništva iz vrijednosti predmeta osiguranja, in Bolanča, D. et al. (ur.), Zbornik radova „*In memoriram* prof. dr. sc. Vjekoslav Šmid“. Rab: Magnus. pp. 222-233.

18. Model law on security transaction EBRD. Retrived 15.05.2017. from www.ebrd.com/pages/research/publications/guides/model.shtml
19. Povlakić, M. (2001). Moderne tendencije u razvoju sredstava obezbeđenja potraživanja s posebnim osvrtom na bezposjedovnu (registriranu) zalogu. Sarajevo: Pravni fakultet Sarajevo.
20. Povlakić, M. (2010). Osnivanje između ugovornih strana i dejstvo prema trećima, prvenstveni red in Civil Law Forum for South East Europe, Collection of studies and analyses First Regional Conference, Volume II. Cavtat: GTZ. pp. 191-217.
21. Romac, A. (1992). Rimsko pravo. Zagreb: Narodne novine.
22. Rušnov, A., Posilović Dr. S. (1911?). Tumač obćemu austrijskomu gradjanskom zakoniku, II. svezak. Zagreb: Tisak i naklada knjižare L. Hartmana (Stj. Kugli).
23. Sale of Goods Act 1979 from http://www.legislation.gov.uk/ukpga/1979/54/section/19
24. Sparrow, R. (2013). Retention of Title: Can 'All Moneys' Clauses and Proceeds of Sale Clauses Ever Work?. The student journal of law, Issue 5: March 2013. Retrived 15.05.2017. from https://sites.google.com/site/349924e64e68f035/issue-5
25. Study Group on a European Civil Code and the Research Group on EC Private Law - Acquis Group, (2009). Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR), Munich: European law publishers. Retrived 15.05.2017. from www.sellier.de
26. UNCITRAL Insolvency Guide. Retrived 15.05.2017. from www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf
27. UNCITRAL Legislative Guide on Secured Transactions. Retrived 15.05.2017. from www.uncitral.org/uncitral/en/uncitral_texts/payments/Guide_securedtrans.html
28. Uniform Commercial Code. Retrived 15.05.2017. from https://www.law.cornell.edu/ucc
29. Vijn, S. (2013). Is harmonization of retention of title necessary and feasible?. Maastricht: MaRBLe Research Papers Vol 4 (2013). pp. 153-186. Retrived 15.05.2017. from http://openjournals.maastrichtuniversity.nl/Marble/article/viewFile/162/110
30. Von Kindl, J. (2008). Eigentumsvorbehalt und Anwartschaftsrecht. Münster: Zeitschrift für das Juristische Studium 5/2008. pp. 477-487. Retrived 15.05.2017. from http://zjs-online.com/dat/artikel/2008_5_100.pdf
31. Wolff, L-C. (2014). Statutory retention of title structures? A comparative analysis of german property transfer rules in light of english and australian law. Burwood: Deakin law review volume 14 no 1. pp. 1-28. Retrived 15.05.2017. from https://ojs.deakin.edu.au/index.php/dlr/article/view/129/128
32. Zakon o obligacionim odnosima Federacije BiH i Republike Srpske, Službeni list SFRJ, 29/78, 39/85, 45/89, 57/89; Službeni list RBiH, 2/92, 13/93, 13/94, 29/03; Službeni glasnik RS, 17/93, 3/96
33. Zakon o obveznim odnosima 1978. Sl. list SFRJ, 29/78, 39/85, 46/85, 57/89
34. Zakon o obveznim odnosima 2005. Narodne novine 35/05, 41/08, 125/11, 78/15
35. Zakon o Upisniku sudskih i javnobilježničkih osiguranja tražbina na pokretninama i pravima, Narodne novine, 121/05
36. Zakon o vlasništvu i drugim stvarnim pravima, Narodne novine, 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

THE CONCEPT OF THE FREE LOAN - AN INSTRUMENT OF PRIMARY SOCIAL PROTECTION IN BABYLONIAN LEGAL SYSTEM

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

ABSTRACT

Although there are a large number of papers in modern legal and historical science dealing with problems related to determination of the characteristics of the institution of loan in different legal systems, even in the oldest ones, researches focused on determining the characteristics and the reconstruction of a free loan are rare and few. Assuming that the primary institute of loan was used in cases of free transfer of consumable items with an obligation to return the same quantity and quality of other things this work is going to determine its relevance in the ancient law. Detailed interpretation of the available legal texts and preserved written documents place the instrument in question exclusively in the relationship of mutual trust between the family and close friends. But other than that, this research will seek to establish the occurrence of free loan in the primary area of social protection of the poor and sick people. The previously mentioned public function of the institute of loan is a sole feature of Babylonian law and, as such, it undoubtedly contributes to the understanding of its development. All this shows that the economic significance of a free loan must be considered separately from the lending business which in the modern legal and economic science is an almost exclusive framework of appearance of this legal institute.

Keywords*: free loan, babylonian law, social protection, poor and sick people, lending business*

1. INTRODUCTORY REMARKS

For the purpose of this research, the phenomenon and structure of interest-free loan will be determined by means of legal definition of the institute in the content of the available legal texts and the reconstruction of the preserved legal documents, which undoubtedly, in some cases, do not maintain the proper formulation of the legal relations referred to in the title. Therefore, starting from the assumption that the appearance of interest-free loan in the earliest legal order is related to the definition of an institute whose fundamental character is the transfer of certain amount of money or certain amount of other replacable things, and the obligation of the recipient to return the same amount of money i.e. the same amount of things of the same kind and quality it will be tried to establish the characteristics of interest-free loan in Babylonian law.

At the same time it should be emphasized that the particular emphasis of this research is on the free contracting of the loan of replaceable and consumable items which, given that the subject of the loan was even in the earliest legal systems exclusively money, and that its characteristic is often interest, it forms a rare form of legaltransactions, considering that, as such, it is economically unprofitable. Thus, the economic purpose of concluding the contract is probably confined to the rare relationship between close friends and acquaintances. To what extent was the application of the mentioned institute socially motivated, it is going to be determined more closely further in the text.

2. CHARACTERISTICS OF A LOAN IN BABYLON

Lending things is one of the oldest legal transactions of ancient law. In the earliest Babylonian law, the loan, as well as modern law, represented a legal activity by which the borrower was obliged to the lender to repay the borrowed things, i.e. the money with the agreed interest or interest-free. Although the Hamurabi Code contains a direct definition of the loan agreement in several legal provisions, they do not mention interest-free loan, but refer exclusively to the interest loan and the grains that were used as means of payment at the time of the First Babylonian Dynasty[1](Middletone, 2015, p. 488). (Schorrr, 1913.; For the purposes of the work, the legal text of the Hammurabi Code (hereinafter referred to as the HC) will be quoted according to: Jasić, 1968, p. 13) In accordance with the provisions of the legal text it can be concluded that loan in the earliest period of Babylonian law was a legally binding contract with the same characteristics that appear in the modern law. In Babylon's law, the loan had a very wide scope of application and is the most common charging agreement, which is already apparent from the content of a large number of legal documents available to us. (Coq, 1918, p.7; Schorr, 1913, p. 65)[2]

The most common subject of the loan agreement was money, wheat, other grains, oil, bricks, wool and other agricultural products.(Coq, 1918, p. 7.; Schorr, 1913, p.66) Unfortunately, from the content of some of the legal provisions of the Hammurabi's Code it is not possible to conclude the appearance and form of interest-free loan, which is the subject of a closer research in this paper. Attempting to recognize interest-free loan in the content of the legal text is further complicated by the presence and unclear delimitation of the clauses on the interest rate and contractual penalty for non-fulfillment of the obligation.[3] The Code does not leave enough space to recognize the appearance and characteristics of interest-free loan. The casuistic nature of Hammurabi's law, as well as other oriental laws, does not allow us to conclude that the lack of a legal definition of a legal relationship indicates the absence of such relationship in the legal reality.

Therefore, determination of the appearance and fundamental characteristics of interest-free loan, in the case of Babylonian law, must be based on available legal documents that may indicate the development of the lawful practice of the legal system mentioned. The aforementioned assertion is particularly contributed by the provision of the Hammurabi Code, which presupposes formalism relating to the obligation to write a compulsory legal affairs and their confirmation before the witnesses as a condition of validity of the mentioned legal affairs.[4] Such legal formalism resulted in a rich and preserved practice through which it is possible to inspect the existence of far more developed legal traffic than the one known from the Hammurabi's Code.[5]

---

[1] The first Babylonian dynasty covers the period between mid-19th and mid-16th century BC.

[2] The loan contract in the Babylonian law constituted a contractual relationship by which one party obliged the other to surrender the amount of money or a certain quantity of consumable items, and the other party obliged to pay the same amount of money or to return the same amount of consumable goods after a certain time; The loan contract in Babylon contained provisions on the subject of the contract, the interest rate, except in rare cases where the loan was contracted free of interest, information on the debtor and the lender, the place and time of the contract, and eventual fine in a case of failing to fulfill the obligations.

[3] See § 48. HC: "If Avilum has a debt and Adad is flooding his field ... in that year wheat will not cause debt to the lord, it will be cleared on a clay board and for that year it will not give any interest as well."

[4] Article 7 of HC: "If anyone without a witness or contract bought or received into custody: gold, silver, male or female slave, cattle or sheep, donkey or anything from the hand of a son or another slave, is considered a thief and deserves death."

[5] From the rich material of about 1250 documents, only the aforementioned Schorr's collection (Urkunden des Altbabylonischen Zivil und Prozessrechts, 1913) was available from 327 documents from various legal branches, whose content refer to various legal affairs. Of fundamental importance for determining the occurrence of the loan contract in Babylon is the review by Édouard Cuq with an account of the newly

It is important to emphasize, as Haase points out, that the old Babylonian law did not encompass the credit activity that made the lending of things in a single nomenclature, but there are forms of loan agreements which are highlighted by special features regarding the characteristics, effects and legal cause of the mentioned relationships.
There are known the following types of loans: interest loan, i.e. a *hubullu*, interest-free loan, *Hubattum*, confidential interest-free loan, *qiptum* and *ana usatim* as a special form of loan for aid and assistance.(Hasse, 1965, p. 86)

2.1. Characteristics of interest-free loan

In the newly discovered fragments from the Hammurabi's period relating to the conclusion of the Loan Agreement, interest-free loan which undoubtedly has the characteristics of a contract concluded between acquaintances or close friends can be identified in two legal documents.[6] (Text of the documents see in: Coq, 1910, p. 24) In both cases, there is a loan of a certain number of clay bricks which the lender lent to the debtor for the purpose of restoring the debtor's home. Both loans were concluded for a period of eight months. The provision on the duration of the loan, i.e. the exact timing of the debtor's obligation to repay the borrowed things, corresponds to the exact time at which the bricks could be made in molds and prepared for use.
Different from the interest agreements that primarily sought to achieve economic gain by lending certain things to the debtor and by returning the same thing of the same quality, but larger amounts, it is obvious that the job in the aforementioned case is aimed at helping a close friend and hence can be classified as a category of legal affairs *amissio rei*. As in the case of the above-mentioned contract, where the subject is the wheat loan, this document, too, excludes the names of the witnesses. Such practice, even when it comes to the earliest period of Babylonian law, allows us to conclude that the contract was concluded between the contractors who are in a very close, trust-based relationship.
The fundamental characteristic of the ancient legal systems, as well as of Babylonian law, were the underdevelopment of formalism of legal transactions, especially contractual relations. In Babylonian mandatory law, there was no terminological difference between the loan for use and loan for consumption, thus the term *Šu-ba-ti*, that is *Šu-ba-ana-ti*[7] (Schorr, 1913, p. 76; Johns, 1904, p. 250), which means "he loaned for use" was used to designate the legal activity of the parties, which in some cases also referred to Hammurabi's regulation of the loan agreement. Since the loan for consumption within the Code contained formally identical characteristics as well as the loan for use in today's sense, it would be necessary to determine if, due to the lack of differentiation of the two institutes, the factual condition which assumes the application of a legally unregulated institute of loan for use could be covered by the institute of loan for consumption.
If the actual difference between terminological expressions loan for use and loan for consumption did not exist in the period of Hammurabi's law, it would also indicate to the earliest possibility of the loan for consumption of untimely things that in the later law were exclusively considered as the objects loaned for use. Bearing in mind that the law of Babylon

discovered fragments of the Hamurabi Code, which regulated the institutes of interest loans and partnership contracts, i.e. partnership.

[6] M. 26 = U. 176. — 1. année de Samsouilouna, 8* mois. — Prêt de 6 sarde briques d'argile (environ 210*), à rendre au mois Douzou (4* de l'année), à l'entrepôt du prêteur.; M. 26 = U. 176. 1. years of the reign of the King Samsouiloun, August, 6 measures of clay brick (cca 210 pieces) and should be returned to the lender in the warehouse in April (Douzu).; BE. VI, 2, 21 = U. 907; S.47. — 4. année de Samsouilouna, 6* mois. — Prêt de 1/2 sar 1 gin de briques à rendre au mois Sivan (3. de l'année).; BE. VI, 2, 21 = U. 907; S.47= 4. 1. years of the reign of the king Samsouiloun, June, ½ measure of clay brick should be returned to the lender in March (Sivan).

[7] Šu-ba-an-ti = sem. Ilteki (No. 1700); Šu-ti meant to loan for use, and ba-an is a reflexive verb infix, i.e. insertion.

recognized interest-free and interest loan, i.e. that the interest on the loan was not necessarily a component of legal transactions between the parties, the interest-free loan for consumption of consumable items fulfilled the assumptions of the loan for use which was as a special legal institute formulated a little later. The surrender of animals marked in legal documents by the expression *"su-ba-ti"* of the ancient Babylonian law was obviously legally formed in the institute of the loan. The animals were rare and their value was extremely high.

There is no known purpose for which such transactions were performed, but it is assumed it was for further reproduction or sale. One document reflects the content of such a legal deal, but its origin is considerably younger than the Hammurabian period. The instrument is dated on 7th July, Iyyar 67 BC. (Johns, 1901, p. 77-78; Johns, 1904, p. 270: Roškar, 2016, p. 14).

It dates from the Assyrian period of Babylonian law. (Collins, 2008, p.159)[8] According to the content of the document, one party (the provider) handed over to the three recipients, two hundred sheep, fifty goats, two hundred and thirty lambs, and five hundred and eighty sheep. They had to return the animals by the date determined in the contract or pay their value. It seems that in this case the animals were not subjected to the individualization of individual heads, but the animals were covered only by type and number. This way the debtor is obliged to return the same number of animals of the same type, so that the legal transaction concluded has the characteristic of interest-free loan contract that was previously seen in several legal documents. From the above example it is evident that the title of legal transaction in legal documents did not often reflect the content of legal institutes that we know today.

In fact, the parties often sought to formally accomplish legal protection in the form of legal work, but due to insufficient legal education in that ancient period, it is not excluded that the content documents so compiled did not often satisfy the legal framework of the institutes. Thus, if the purpose of legal transaction in this case was indeed the use of animals for reproduction, and there is no obligation of the debtor to return the same animal to the lender (in which case it would be the case of loan for use), the document undoubtedly enabled the creation of an interest-free contract on the loan for consumption. Furthermore, assuming that the parties had in mind the return of the same things to the debtor, even in that case there would be formally formed an interst-free agreement on the loan for consumption, since the loan for use, as a special contractual relationship in the earliest period of Babylon's law, was still not legally framed. The prominent characteristics of an interest-free loan for consumption in later periods of Babylonian law are confirmed by Guillaume Cardascia in his review of documents on Babylonian legal affairs from the period of the Ahemendic Persian Empire (Kuhrt, 2007, p. 13)[9], *Les Archives der Murašû*. (Cardascia, 1951, p. 174-175) The insight into the documents faithfully displays some activities within the credit activities through which the economic interests of the representatives of different social layers are realized, on the one side by the employer and his employees on the other side. Two documents from a wealthy collection[10] of the famous Murašu family of retailers refer to the loan institute. The first document contains information on money lending, clothing and food and is concluded between the banker and his servants for the purpose of carrying out a joint mission. (Cardascia, 1951, p. 173-174; Roškar, 2016, p. 15).

[8] During the reign of the Assyrian king Aššurnasirpal II (883-859), Assyrin empire expanded to the Babylonian area, which in the 9th century BC was too developed in the social and legal sense to receive the status of the province.Tiglath-Pileser III (742-727) united the two countries into a personal union, thus, since the second half of the 8th century BC Babylonian and Assyrian law have common characteristics.

[9] The Agamenian Persian Empire was the first Persian Empire which from 550 to 330 BC encompassed the area from Great Iran, i.e. II Iranian Emperor Dynasty (after the Median Empire).

[10] Murašu is the name of the well-known Nippur family of merchants whose legal transactions and affairs were recorded in the period between the reign of the rulers Artaxerxes I and Darius II. Legal affairs of the family were manily concluding the contracts in the agricultural field, especially leases and credit transactions.; Cardascia (1951) p. 10-11.

Although the content of the document cannot be completely reconstructed without the difficulty, the purpose of surrendering the matter refers to a very close relationship between the contracting parties, and the form of the document (the form of debt recognition) indicates its interest-free character. The special case of a loan contract for agricultural products in the period of later Babylonian law are the contracts terminologically marked by the term *hubullu*[11], which signified a free loan of products, primarily agricultural, which in the period of later Babylonian law are often concluded in legal relations between the acquaintances.[12] (See more: Maidman, 2012, p. 4-5) These contracts enabled the transfer of items solely for personal purposes. For this reason, these contracts may be characterized by marks inherent in free friendly legal affairs. Such contracts were most often concluded between the creditor and his employees, associates and acquaintances.(A detailed inspection of the documents in which the transfer of the product to the mentioned persons was noted see in: Stein, 1993, p. 197- 199) The subject of these contracts was, as has already been said, agricultural products, mostly barley. The term of the contract, as well as the timing of the debtor's obligation, depended on the time period during which the products were available. For example, the contracts were concluded before harvest, and after the harvest, the borrower was obliged to repay the leased agricultural products. (Hay, 2014, p. 72) Often, in the group of documents where the expression *hubullu* is found, the names of witnesses are not mentioned. Such practice places the mentioned legal affairs in the category of informal contracts which, judging from the aforementioned characteristics of interest-free loan, were concluded solely between persons affiliated with close relationships of mutual trust.

In the same way as in the aforementioned case, documents with a very similar terminological character, *hubattu*, in historical-legal science is marked as an interest-free loan. However, with a careful interpretation of the content and significance of certain documents Shiff observed the meaning of the term *hubatti* in another context, as a loan concluded for a relatively short period of time in which the interest, although not specifically contracted, is included in the amount of principal borrowed. (More on the Institute see in: Shiff , 1988, p. 187 with the reference to the literature written in a note 3.) The meaning of the term *hubattu* in the new Babylonian Law can no longer be linked to the loan institute, which is replaced by a special document, such as a debit note[13], as a specially debated and written transaction. For this reason, the notion of interest-free documents under the aforementioned *hubattu* term has no particular significance for the content of this research. (Schiff, 1988, p. 189)

2.2. Meaning of the clause *ina baltu ù šalmu* in the documents on interest-free loan

By looking into the available legal documents that will be analyzed below, one can conclude on the fundamental caracteristics of interest-free loan which, when it comes to the period that Schorr refers to[14], refers to a very diverse credit activity between the temple of god Shamas and the needy Babylonians. The interesest-free character of a loan from the aforementioned

[11] The term *hubullu* meant a debt, a loan with interest. According to: A Concise Dictionary of Akkadian edited by Black, Jeremy A. George, Andrew, Postgate, J. N., Otto Harrassowitz Verlag, Wiesbaden, 2000. In most legal sources this term is assosiated with the institute of interest-free loan. In that context it can be concluded that in the aforementioned cases the term *hubullu* should be interpreted only as the existence of ratification of things, not as an interest-free characteristic of a loan.

[12] Documents in which this form of free loan is clearly visible is from the period 1500 to 1350, B.C. Documents are contained in the collection of the title Nuzi Documents. The same were found when excavating the ancient city of Nuzi in the area of today's northern Iraq.

[13] Unlike the conclusion of the loan agreement, which marked the fomalization of the conclusion of the legal transaction, the debenture signified the existence of a debtor's obligation.

[14] Ammi-Ditana was the king of Babylon who ruled from 1683 to 1640.

documents derives from the provision for repayment of the loan.[15] (Schorr, 1913, p. 67) Clearly, in this case, it is a loan of consumable goods, i.e. wheat, and that the borrower was obliged to return the same amount of wheat for a certain period of time.

From this, basic characteristics of interest-free loan agreement can be identified, although they are not explicitly stated in the content of the document. The place and time of the conclusion of the contract, the names of the contracting parties and the time of the fulfillment of the obligation to return things are the underlying contents of each document and they are not exception in this case as well. With regard to the facility of interest-free loan, it is quite clear that the use of the mentioned instrument was equally justified in the case of lending money, precious metals and consumables, which are the main object of this research, such as the aforementioned case of wheat and wool[16]. Fulfillment of a contractual obligation in some cases, other than returning the same amount of borrowed things, is made possible by the return of other things, most often money or precious metals.

Although the aforementioned documents bear witness to the appearance and legal regulation of a free loan in the 17th century B.C. The fact that the creditors of the aforesaid legal affairs are the administrators of the temple or court indicate that in these cases, however, these are not the case of private legal affairs *amissio rei*, but the contracts concluded between the public and administrative services of these individuals, and are therefore marked by certain particulars. By interpreting the contents of these documents, it is clear that the temples, otherwise known as places for holding religious ceremonies in ancient systems, maintained some other public services. Thus, for example, the activity of a temple in the field of financial business could be accomplished with the achievement of economic gain, and hence the temple would play a role in the field of credit business or without the economic gain, making the temple a significant factor in the field of primary social security instruments.

In spite of the fact that the contracts that are dealt with below could be classified into the category of free transaction of very limited circumstances in which their conclusion was possible they refer to their rare application. Therefore, it is necessary to determine further in the text the existence of the above contracts, the circumstances in which the items were loaned interest-free, and to determine the social framework and the economic purpose in which their application was justified.

The purpose of these interest-free contracts was socially motivated given that public officials in some cases were authorized to conclude interest-free loan agreements with sick people who were liable to return loaned money in case of healing. Instead of increasing the wealth and economic gain of the temple, the agreements were set out so to make it easier for the poor through a difficult period of their illness. (See more about the peculiarities of an interest-free loan agreements for the sake of healing the poor in: Coq, 1910, p. 26) In similar cases of economic dependence there was a possibility of interest-free lending which provided food and shelter for the purpose of satisfying the basic existential needs. (Leick, 2003, p. 78) In addition to providing these loans with the help of the necessary temples, they provided the workforce for doing affairs of social interest. (Leick, 2003, p. 78)

Some of the free loan agreements contained a specific clause *ina baltu ù šalmu*, which had particular significance for defining the borrower's obligation to return the item, making a

[15] An example of the mentioned document content can be seen in the document that Schorr marks as 56: *Sippar*, 10. *Warahsamna*, 35th *Ammi-sitana*. The contents of the document are as follows: 1 measure (Kur) of wheat belonging to God Shamamsh, was loaned by Shamash to his master, Lu-iškurra, the son of Ili-usati. Shamash will keep him from illness and injury. 10. Warah-samna, in the year that King Ammi-ditan was set up.

[16] The Schorr found the loan of wool in a document 55: *Sippar*, 26. *Elulum*, 29 *Ammi-ditana*. The contents of the aforementioned document refers to a free loan agreement concluded between the Temple, through an agent and a borrower who is enabled to meet the contractual obligation by returning the lender's wool or its silver equivalent.

refund valid at the moment when the debtor was "in health and peace. (Bromberg, 1942, p. 81-82)[17]" The implication of the clause in the Free Loan Contracts caused, however, many difficulties in trying to determine its true meaning. For this reason, it is particularly important to refer to the interpretations provided in the available literature and to determine the content of the individual documents that contain this clause.

Schorr interpreted this clause in the sense of a closer determination of the contractual obligation to repay the borrowed things. (Schorr, 1913 p. 69-70) He wanted to emphasize that the debtor's obligation to return things, whether expressed in cash or grain and fruit, must fully correspond in its weight and quality to the borrowed thing at the time of the conclusion of the loan. Scheil considered that, unlike the aforementioned interpretation, the clause *ina baltu ù šalmu* should be interpreted as a result of the vow that enabled the poor and the sick to receive "the remedy of God's grace".(Scheil, 1916, p.131) In the author's opinion, in these cases, there were loan agreements in which the obligation to repay the borrowed things matured in the moment of the healing and solvency of the debtor. (Harris, 1960, p. 133) In the same sense, a series of documents quoted by Kohler can be interpreted, which undoubtedly point to the conclusion of interest-free loan between the temple and the individual in need. (See documents No. 164 p. 47, No. 187. p. 51, No. 189 in: Kohler, Peiser, 1909, p. 47 and 51) In one case, it is a money loan, i.e. silver, and the other two cases are the loan of grain. When it comes to the poor people who were forced to borrow the funds of the temple, the object of the loan was more often grain. This made possible for individuals to repay the loan immediately after the harvest. Loaning money was more often a chargeable legal transaction and the purpose of such transaction was regularly fulfilled within the scope or expansion of the transaction of borrowers. Under the assumption of the correctness of the philological interpretation of the aforementioned sources in all these cases, it is quite clear that the time of the return of things was not contracted and the debtor was allowed to repay the debt at the point in which it would actually be *in favorem* for him. These contracts are unquestionably characterized by primary social security activities, far from credit transactions, which is, concerning the loan in general, from the earliest period of the existence of Babylonian law, the most common way of achieving economic gain.

In some sources, a different interpretation of the application of *ina baltu ù šalmu* clause is available. The loan agreements that contained the aforementioned clause Koschaker called a fictitious loan.(Koschaker, Ungnad, 1923, p. 46 with special reference to note 1.) [18] This would mean that the documents marked by the clause looked like a loan only formally, i.e. by its form, while their content was far from a loan, since the documents did not cover the obligation to hand over things to the lender, but only the obligation to surrender, i.e. to restore certain things to the temple of God Shamas. This would mean that due to the non-existence of the special legal form for gifting the god Shamas, the individuals used the form of a loan agreement, to which they added the clause *ina baltu ù šalmu*, which obliged the surrender of the thing to a moment that was favorable to the debtor. It seems that the object of such documents were the objects made of precious metals that had religious features. (Hariss, 1960, p. 135) It should be noted, in particular, that in the documents cited by Hariss the clause is formulated by the inversion of the aforementioned clause and it reads like this *šalmu baltu*[19].

[17] Bromberg also cites the example of a free loan concluded between God Shamas and a debtor in the 17th century BC: "1 gur of wheat belonging to Shamas, condemned Mulu-Iškurr, the son of Ilu-usati of Shamas, his god. *Ina baltu ù šalmu* restore debt to Shamas, his God. The contract was concluded without a witness. "

[18] The author emphasizes that in cases of a temple loan the borrower, who is usually a sick person, promises a sum of money or other products in return for healing. As the stated statement is a vow, given in the form of a loan, the author calls it a fictitious contract..

[19] The earliest period from which such documents originate is the period of King Samsilon's reign.

The content of all the mentioned documents quoted by the author undoubtedly testifies to the oaths that the borrower takes, and thus hands over things to the lender, god Shamas. However, in the content of the document the obligation to hand over things to the borrower appears to be the only obligation that is the content of this exceptional transaction. Such an example is evident in the contents of the text: *"1 1/6 shekel ... a sun disc weighing 1/3 of a shekel Ilum-tajjar owes to Shamas.*
After healing, he will hang a disc around the neck of Shamas during the gulbatu festival." (Hariss, 1960, p. 135) [20] The purpose of compiling the document in this case as well as other documents (Szlechter, 1958, p. 21)[21] alleged by the author is the handing over of the disc to Shamas as a gift to restore health. This is the surrender of things that can be seen before as a donation institute concluded on the form of a loan rather than a loan of things. (For other documents refering to similar form of transactions look up in: Hariss, 1960, p. 135, 136) [22]

If the meaning of the clause *šalmu baltu* had to be observed only by the contents of one-sided documents containing the "borrower's" vow, it would not be possible to interpret them as an institute relevant to the content of this research. For this reason, the contents of two-way obliging documents that are extremely rare in Babylon's law are of great importance for determining the legal affairs of the temple in the area of primary social security. An example of such a document is H. E. 133. (Boyer, 1929, p. 50) A copy of which the text is not completely preserved refers to two transactions. The first, which involves the surrender of a solar disc in the value of 1/3 of shekel of silver and resembles the vow of " *ina baltu u šalmu* " in the case of healing. And another, which obliges a son Eadani to repay the loan his father took over from God Shamas, which he obliged to return at the time of healing. This loan amounted to 1 shekel and 15 silver grain, and 61 *gur* and 80 *qu* of wheat. Assuming that the obligation to return the borrowed things came about on the basis of a legal transaction in which the father loaned a certain amount of silver and wheat in the aforementioned case it is a loan of a thing carried out in the midst of unfavorable circumstances of the borrower for the purpose of achieving health and peace. Surrender of the sun disc represents a vow of the borrower who rewards Shamas with the gift for the achievement of favorable material and existential circumstances. The content of the second part of the document is relevant to determining the details of the return and will be analyzed below. This may call into question the aforementioned theory of fictitious borrowing, which, by trying to argue the role of the vow in the content of certain preserved documents, apparently had in mind only those sources that were one-way obliging. Below is provided an example of a document whose content leaves no room for doubt as to the conclusion of a loan agreement with a loan repayment clause in a case of healing. No. 189. S 76: *"2 gur of wheat in the measure of Shamas and 2/3 of the silver shekel that the god Shamas paid to Warad-Nabium, the son of Maktum-Lizzis. Healthy and complete he will bring it to the house of Shamas, and pay to Shamas, his master."* (Koschaker, Ungnad, Hammurabi, 1909, p. 51, See also a document No. 164. which referes to the same form of the loan agreement with the clause in question.) Although the content of the document refers to the vow, we can safely assert that the loan item is listed in its first part as a proof of the existence of the social role of the temple in Babylon, which, as we have previously assumed, is a significant factor in achieving the general well-being of the citizens of that ancient order.

[20] YOS 12 15. According to: Feigin, S. I., Legal and Administrative Texts of the Reign of Samsu-iluna, by with introduction and indices by A. Leo Oppenheim, with the assistance of Mark E. Cohen. Yale Oriental Series, Babylonian Texts, vol. 12. New Haven, Yale University Press, 1979.
[21] The author refers to the document No. 16660.
[22] Especially a document labeled MAH 16. 660 which undoubtedly speaks of surrender of silver objects at the time of achieving health. Szlechter, 1958, p. 21.

If we compare the contents of this document with the mentioned above YOS 12 15, it can easily be seen that the last document, differently from the first one, testifies to the debtor's obligation as a result of surrender of things to Shamas. There was no word about delivering things in the earlier document. Another argument in support of the allegation of two transactions in some legal transactions containing the *šalmu baltu* clause, the first handing over of the lender, and then its return upon the healing time of the borrower, is also cited by Harris by referring to CT 5 4: 6. (Hariss, 1960, p. 135)

The most significant issue arising from the research of the institute in Babylon is the legal consequences that may arise in the event of a failure to fulfill the obligation assumed. It should be noted immediately that the reason for the absence of a commitment may have different consequences depending on whether the obligation imposed on the debtor has been fulfilled, i.e. whether the debtor has reached a favorable period in which the conditions for returning the goods have been fulfilled. Under the assumption of a favorable period in the life of a debtor, i.e. healing or economic security, the period of benefit would cease to exist. The meaning of the clause "*ina šalmu u balta*" Landsberger interprets very reliably as a mark of the exact time of returning the borrowed things.(Landsberger, 1923, p. 26) From the moment of healing or achieving material security, the borrower's obligations is considered a due date, thus he was obliged to return the borrowed things. As the documents containing the clause "in health and peace" did not contain any specific guidance on the consequences of non-fulfillment of contractual obligations, we consider it appropriate to apply the general provisions of the Babylonian law in this case. In legal documents about interest-free loan that contained a penalty clause in the event of the lack of repayment of the loaned objects, one can see the basic purpose of interest-free loan of things. Namely, a free loan is marked by a friendly service marked by the credibility of the lender. However, such a well-intentioned service had time limits that alerted the borrower to the existence of an obligation to return things. In cases where the borrower ignored this obligation, he was obliged by the contractual clause to return the multiple value of the leased assets. (Coq, 1910 p. 46) According to Coq, interest-free loan contracts that contained the penalty clause obliged the borrower to pay double the amount of the loan. (Coq, 1910 p. 47) Also, there was the possibility of such an arrangement which made the interest rate dependent on the delay time. As the debtor deferred with the repayment obligation, the amount of things he had to pay back increased by the months of delays. (Coq, 1910 p. 47) [23] This way the primarily interest-free institute, which had the characteristics of helping the needy, by delaying the borrower became a charging instrument. In the case of the healing of the borrower, he had to bare the consequences, which, in the case of a regular interest-free loan, included the interest, comon in legal transactions between private persons.

Another important issue arises from the reconstruction of the agreement with the clause "*šalmu baltu*", i.e. "*ina baltu u šalmu*". Bearing in mind that the clause listed in the interest-free loan agreement in Babylon with the intention of obliging the borrower to repay the borrowed things at the time when it is possible, i.e. when health and material circumstances enable the restitution of debt, it is impossible not to wonder what happenes with the obligation of restitution if such circumstances never occur (the case of the debtor's death)? Was the debtor fully engaged in the contractual obligations if he was not cured or was one of his family members obliged under the threat to repay the loaned interest by threatening interest or ultimate debt service? By detailed exploration of the content of all available documents that contained this clause, we tried to determine the circumstances and consequences of non-fulfillment of the contractual obligation. The circumstance that the documents in the content do not indicate to any contractual penalty and do not state the

[23] A debtor was obliged to pay a double monthly interest rate for each month of delay.

interest rate for the debtor's default is not a sufficient argument of the claim that the borrower has waived the obligation to return the goods in case the circumstances covered by the clause *ina baltu u šalmu* did not occur. On the other hand, we believe that in the case where the lender tried to secure himself in case of the borrower's death, even the Babylonian law was familiar with the contractual provisions which obliged the son of the borrower to compensate the agreed amount of money, i.e. things.[24]

As the reference to the heirs responsible for the fulfillment of the obligation in all the aforementioned documents concerning the free loan of things is excluded, it can be argued that such obligations did not exist. Only with such an interpretation contracts with the cure of healing or achievement of favorable living conditions of the borrower can be considered the primary form of social protection of the citizens of Babylon.

3. CONCLUSION

Loan contract is undeniably one of the most frequent legal affairs of social reality recorded in the earliest legal systems and defined in the oldest legal texts. Although the loan in Babylonian law is a regular instrument of payment nature, this research sought to establish the purpose and legal relevance of the use of an interest-free loan. Although the characteristics of this institute are not defined by the content of the legal text, the insight into legal affairs has confirmed its application in legal relations between acquaintances and close friends. The purpose of the conclusion of interest-free loan agreements has certainly defined the occurrence of the institute within the private legal sphere. In this context, the assistance that was realized through interest-free loan of items was returned to the lender in the agreed time period in the same amount and the quality of the surrendered items. Regarding the fundamental characteristics an interest-free loan, therefore, since the period of babylonian law, retained its distinctive form in the contemporary law. The specialty of the Babylonian interest-free loan is certainly a loan agreement that was concluded between the individual and the temple, i.e. the public authorities, with the purpose of providing the assistance that the borrower had to return under the condition of "*ina baltu u šalmu*" healing or achieving favorable living circumstances. In order to be able to talk about the primary social function of an interest-free loan with the aforementioned clause "*ina baltu u šalmu*", it must be particularly careful to determine whether certain documents containing the clause in the text were either bilateral or unilateral, only contained the covenant of the patient, who was, in the case of healing, obliged to reward God Shamas for achieving health. The presence of the clause in the bilateral loan agreements determined the purpose of such contracting and the fulfillment of the debtor's obligation. Such contracts, provided that they are bilateral contracts, i.e. that they testify the lending to the borrower and the return to the lender, established a socially justified function of social assistance to the person in need at the time of their illness or some serious life circumstances. In this way, the temple as a representative of the public authorities assumed the role of caring for the sick until the time of their economic independence. For this reason, an interest-free loan can be considered as the primary form of social security characteristic, to the best of our knowledge, exclusively to Babylonian law.

LITERATURE:

1. A Concise Dictionary of Akkadian edited by Black, Jeremy A. George, Andrew, Postgate, J. N., Otto Harrassowitz Verlag, Wiesbaden, 2000.
2. Boyer, G., Contribution à l'histoire juridique de la première dynastie babylonienne, Paris, 1929.

[24] See previously mentiond document H. E. 133.

3. Bromerg, Benjamin, The origin of Banking: Religious finance in Babylonia, The Journal of Economic History, Vol. 2, No. 1. 1942.
4. Cardascia, G., Les Archives der Murašû. Une famille d`hommes d`affaires Babyloniens a l`epoque Perse (455-403 Av. J.-C.), Paris, Imprimerie Nationale, 195.
5. Collins, P., From Egypt to Babylon: The International Age 1550-500 BC, Harvard University Press, 2008.
6. Cuq, É., Les nouveaux fragments du code de Hammourabi sur le prêt à intérêt et les sociétés, Paris, Impr. Nationale, 1918.
7. Feigin, S. I., Legal and Administrative Texts of the Reign of Samsu-iluna, by with introduction and indices by A. Leo Oppenheim, with the assistance of Mark E. Cohen. Yale Oriental Series, Babylonian Texts, vol. 12. New Haven, Yale University Press, 1979.
8. Haase, R., Einführung in das Studium keilschriftlicher Rechtsquellen, Weisbaden, Otto Harrassowitz Verlag, 1965.
9. Hariss, Rivkan, Old Baylonian Temple Loans, Journal of Cuneiform Studies, Vol. 14, No. 4 (1960).
10. Hay, Francis Anthony Mirko, Trade in Mesopotamia from the Early Dynastic Period to the Early Achaemenid Period with Emphasis On the Finance of such Trade, 2014.: http://uir.unisa.ac.za/handle/10500/18530, 22.04. 2017.
11. Jasić, S., Zakoni starog i srednjeg vijeka [Old and Middle Ages Laws], Belgrade, 1968.
12. Johns, C., H.,W., Assyrian deeds and documents recording the transfer of property, including the so-called private contracts, legal decisions and proclamations preserved in the Kouyunjik Collections of the British Museum chiefly of the 7th Century B.C., copied, collated, arranged, abstracted, annotated, and indexed, Cambridge, Deighton, 1901.
13. Johns, C., H.,W., Babylonian and Assyrian Laws, Contracts and Letters, The Lawbook Exchange, Ltd., 1904. : http://oll.libertyfund.org/titles/johns-babylonian-and-assyrian-laws-contracts-and-letters, 18.04. 2017.
14. Kohler, J.,. Peiser, F.E., Hammurabi, King of Babylonia, Band III., J. Leipzig, 1909.
15. Koschaker, P., Ungnad, A., Hammurabi, King of Babylonia, Band III., J. Leipzig, 1909.
16. Koschaker, P., Ungnad, A., Hammurabi, King of Babylonia, Band VI., J. Leipzig, 1923.
17. Kuhrt, A., The Persian Empire: A Corpus of Sources of the Achaemenid Period, New York, Routledge 2007.
18. Landsberger, B., Solidarhaftung von Schuldnern in den babyl.-assyrischen Urkunden, Zeitschrift für Assyriologie und verwandte Gebiete 1923, Vol. 35 (1)
19. Leick, Gwendolyn, The Babylonians: An Introduction, Psychology Press, 2003.
20. Maidman, Maynard Paul, Nuzi Texts and Their Uses as Historical Evidence, Society of Biblical Lit, 2010.
21. Middleton, John, World Monarchies and Dynasties, Routledge, 2015.
22. Roškar, J., Loan for Use in th European Legal Tradition, Zagreb, 2016.
23. Scheil, V., Notules, Revue d'Assyriologie et d'archéologie orientale, Vol. 13, No. 3 (1916)
24. Schorr, M., Urkunden des altbabylonischen Zivil und Prozessrechts, Leipzig, J.S. Hinrichs, 1913.
25. Shiff, Laurence, Neo-Babilonian „Interest- free“ Promissory Notes, Journal of Coneiform Studies, Vol. 40, No. 2, 1988., p. 187
26. Stein, Diana, Wilhelm, Gernot, Das Archiv des Silwa-Tessup, Otto Harrassowitz Verlag, Wiesbaden, 1993.
27. Szlechter, E., Tablettes juridiques de la 1re dynastie de Babylone: conservées au Musée d'Art et d'Histoire de Genève, Paris, 1958.

MISSING TRADER FRAUD AS PART OF ORGANISED CRIME IN EU

Lucija Sokanovic
Faculty of Law – University of Split, Croatia
lucija.sokanovic@pravst.hr

ABSTRACT

Paper aims to present and analyse Missing Trader Fraud as the abuse of VAT rules on cross-border transactions within the EU through research of its different types: Acquisition fraud, Carousel fraud, Contra-trading. Though MTIC fraud is an issue of interest of experts in economy, accounting, financial law, tax law, it is rare in the focus of experts of criminal law who are engaged in prosecution and conviction of this criminal offence. Its very nature though requires specific knowledge and additional education of criminal law jurists in order to provide effective and above all legal criminal proceedings. The great jeopardy of this crime does not only derive from the high material damages caused, but from the meticulously organised and numerous perpetrators. Legal mechanism in combating MTIC fraud is sophisticated and well structured, noting the great importance of cooperation in information exchanges. Analysis elaborate problems detected in earlier practice of the European Court of Justice of the European Union; in the Kittel and Recolta Recycling Case from 2006, as well as the recent judgement in the Case of Ivo Taricco and Others. Specific questions regarding MTIC fraud in Croatia are developed in particular.

Keywords: *Missing trader fraud, organised crime, VAT, tax evasion, criminal offence*

1. INTRODUCTION

Tax evasion and tax avoidance extending across the frontiers of Member States lead to budget losses and violations of the principle of fair taxation. They are liable to bring about distortions of capital movements and of the conditions of competition and thus affect the operation of the internal market. Namely, the abolition of barriers to internal trade in 1992 required further changes to the system of VAT applied to intra-Community trade. Member States adopted a system under which intra-Community transactions were zero-rated. In that way, an exporter would not charge VAT, but would be able to claim a refund of input VAT; a purchaser would not pay VAT, but would have to charge it on subsequent sales and remit the VAT income to its fiscal authority. Thus consumption was taxed in the importing country (House of Lords, European Union Committee, 2006, § 5, 6). So, importers of goods were thus able to receive goods without paying VAT, but charged VAT on their resale. Truancy of remitting the received VAT to the revenue authority could amount to crime: Missing Trader Fraud. Paper aims to present and analyse Missing Trader Fraud as the abuse of VAT rules on cross-border transactions within the EU through research of its different types: *Acquisition fraud, Carousel fraud, Contra-trading*. Though it is an issue of interest of experts in economy, accounting, financial law, tax law, it is rare in the focus of experts of criminal law who are engaged in its prosecution and conviction at the end. Its very nature though requires specific knowledge and additional education of criminal law jurists in order to provide effective and above all legal criminal proceedings. The great jeopardy of this crime does not only derive from the high material damages caused, but from the meticulously organised and numerous perpetrators.

2. WHAT IS MISSING TRADER FRAUD?

2.1. Basic terms

Missing Trader Fraud or more precise Missing Trader Intra-Community (MTIC) is a sophisticated economic criminal activity exploiting Value Added Tax (VAT) evasion

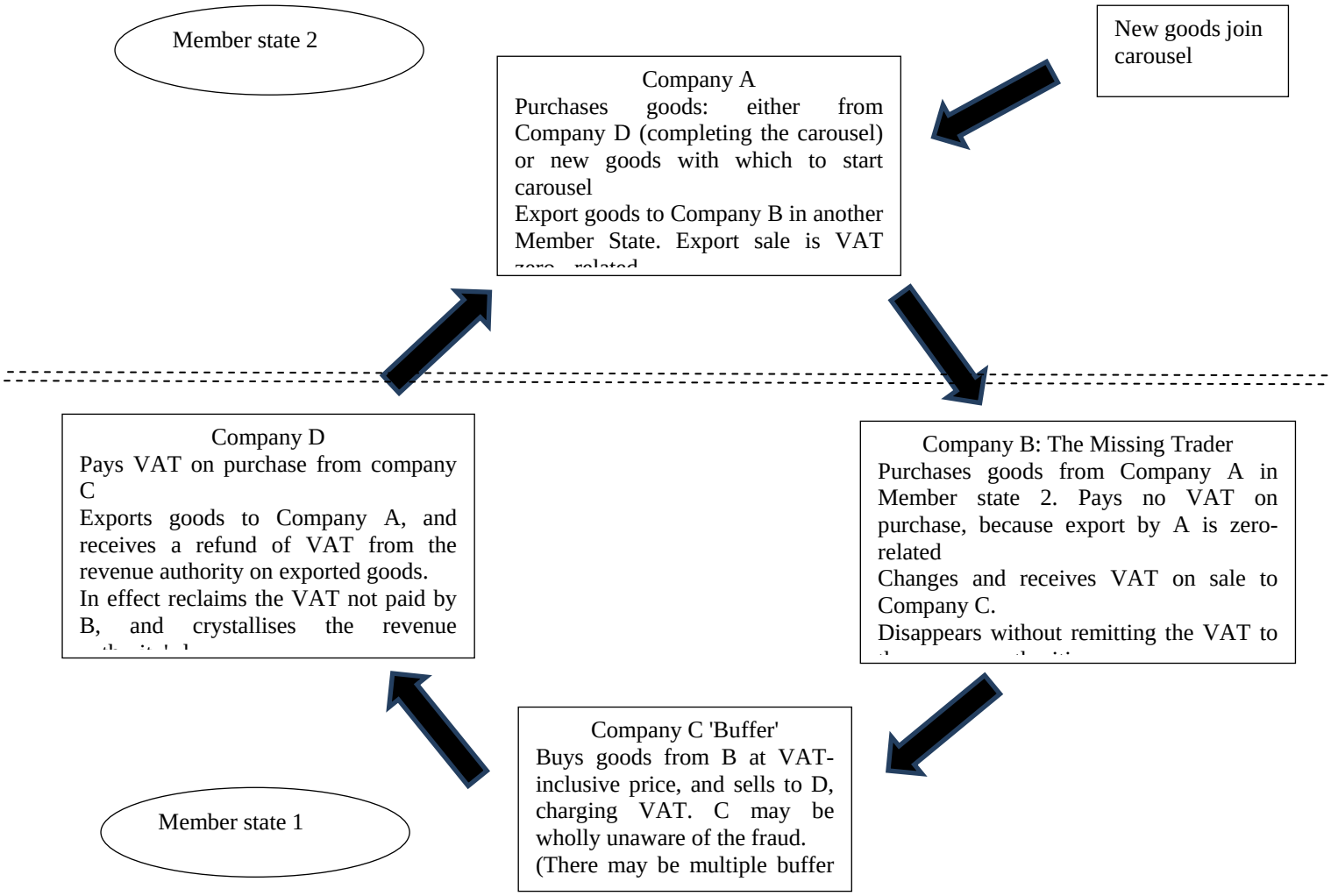
(Jedrzejek *et al*., 2013, p. 70) or the abuse of the VAT rules on cross-border transactions within the EU (Out-Law.com, 2017). According to Europol, MTIC fraud is the theft of Value Added Tax (VAT) from a government by organised crime groups (Europol, 2017). Furthermore, the basic MTIC fraud involves organised, sophisticated activities that seek to exploit differences in how VAT is treated in different EU Member States. Namely, the criminals create a structure of linked companies and individuals across these states in order to abuse both national and international trading and revenue-accounting procedures (*Idem*.). In its simplest form this type of fraud involves obtaining a VAT registration number in an EU member state for the purposes of enabling them to trade and then purchasing goods free from VAT in another EU member state, selling them at a VAT-inclusive purchase price in their country and then going missing or defaulting without paying the VAT to the Government (FATF, 2007, p. 21). In 2007, assessments of the European Commission graded the size of MTIC fraud up to 10% of VAT receipts (House of Lords, European Union Committee, 2006, § 13). The VAT Gap is a measure of VAT compliance and enforcement that provides an estimate of revenue loss due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies, as well as miscalculations (CASE, 2016, p. 8). It is defined as the difference between the amount of VAT collected and the VAT total Tax Liability (VTTL). In 2016 the Gap between expected revenue and revenue actually collected is estimated at 170 billion Euro, while cross-border fraud alone accounts for 50 billion Euro of revenue loss each year (European Commission, 2016, p. 3). The smallest Gaps were observed in Sweden (1.24 percent), Luxembourg (3.80 percent) and Finland (6.92 percent). The largest Gaps were registered in Romania (37.89 percent), Lithuania (36.84 percent) and Malta (35.32 percent) (CASE, 2016, p. 8). Missing trader is a VAT taxable person that collects VAT on sales and then disappears, absconding with the VAT collected (Podlipnik, 2012, p. 461). He refers to a company that is always at the beginning of the chain and effectively facilitates the theft of the VAT by not accounting for it (FATF, 2007, p. 25). Often the company is bought off the shelf from company formation agents and is registered at an accommodation address. Named directors are either front men or completely fictitious (*Idem*.) Other persons involved in the fraud are *broker*, *conduit trader* and *buffer trader*. *Broker* is the exporter at the end of the chain of transactions. The brokers are key facilitators to the fraud by buying goods from buffers and supplying other Member States to obtain a VAT repayment. In some cases this may involve them featuring in more than one carousel chain of transactions (*Idem*.) *Conduit trader* is trader that buys in from one country and immediately sells to another country (*Idem*.) The fraud could work with the missing trader selling directly to the exporter. However, this would endanger the existence of the exporter if all transactions involved dealing with companies without any tangible assets or identity. Therefore, another company is out into the chain to act as a buffer to distance the exporter from the missing trader (*Idem*.) The majority of the fraud is being undertaken by a small number of sophisticated criminal gangs (House of Lords, European Union Committee, 2006, p.30). Two basic conceptual models of MTIC fraud are *carousel fraud* and *acquisition fraud*. The third, hybrid model is *contra trading* (Buterin *et al*. 2014, p. 93).

2.2. Carousel fraud

Carousel fraud is a financial fraud that results with damaging of the state budget by abuse of the VAT system. The missing trader purchases goods from a supplier in another EU State. The missing trader then sells the goods to a business and charges VAT. The missing trader then disappears without paying the VAT to HMRC. The buying business sells the goods to a second business and charges VAT. It pays the excess VAT received from the second business to HMRC. The same happens on a sale between the second business and any third and subsequent business. The last business in the chain sells the goods to a broker. The broker

exports the goods to an EU customer without charging VAT as this is a cross-border transaction within the EU. The broker then reclaims the VAT he has paid when purchasing the goods. In doing so, the broker is effectively reclaiming the VAT not paid by the missing trader and crystallising HMRC's loss (Out-Law.com, 2017). The main difference between MTIC and carousel frauds is therefore that goods or tradable services eventually make their way back to the original seller, completing the loop and this is the explanation for the term "carousel" as well (Podlipnik, 2012, p. 463). Until 2006 the majority of the frauds have centred on the mobile phone and computer chip sectors. Afterwards, the focus was shifted to cosmetics, "precious" metals and computer software. The targeted industries involve high value/low weight goods or service industries and industries with a significant grey market (House of Lords, European Union Committee, 2006, § 17). In the most simple form carousel fraud is operating as follows: company "A" in one EU country purchases goods from a supplier in another EU country at a zero VAT rate. Having acquired the goods, he supplies them to another trader (company "B", within the same country) for a price plus VAT. However, company "A" does not pay the VAT to the EU Member State and becomes a "missing trader". Company "B" then supplies the goods to an EU country (often the same company as the original supplier) and claims back the VAT that he has paid when he bought the goods from company "A". Company "B", known as the "broker" is willing to buy because company "B" knows he has a market for the goods as part of the overall scheme to defraud. When Company "B" supplies the goods to a company elsewhere in the EU, he can claim back the VAT that he paid from the EU Member State (FATF, 2007, p. 21).

Figure 1: A simple VAT carousel (House of Lords, European Union Committee, 2006, p.9)



The English type of VAT carousel scheme for example, has the following features: conduit traders appear at both ends of the chain. This means that tax duty obligation appears earlier than a tax reclaim request. This could be irrelevant in practice if all transactions happened in very short period of time. Object of the sale are goods such as mobile terminals and computer chips – high value, low volume. Transactions are of high value and occur in spurts (this could be easily stopped by inspecting Financial Intelligence Unit data). There is no doubt that goods crossed the border. Usually, it was not clear what happened with goods after they left UK. They could start another carousel chain. Goods could be country specific, for example mobile terminals specified to a given country (Jedrzjek *et al.*, 2013, p. 72-73).

2.3. Acquisition fraud and Contra trading

Acquisition fraud implies the sale of imported goods at a zero rate of VAT on the domestic black market. The importer does not charge VAT on taxable deliveries after the sale, and in this way, he can sell the goods cheaper than other market participants. Since he does not charge VAT, he directly damages the State budget. In this specific case, it is easy to prove the criminal offence, so the prosecution is easier as well (Buterin *et al*., 2014, p. 93). *Contra trading* is conducted for the purpose of prevention of detection of MTIC fraud. It is the most sophisticated scheme. The term contra trader refers to taxpayer who participates in two distinct types of transactions, one of which is legal and implemented with an aim to conceal carousel fraud (*Idem*). Or, the "broker number one" does not submit a claim to HMRC to obtain a refund of the VAT charged to it. Instead, he uses a "clean" deal chain to offset the VAT. This means that he imports goods from another EU state, and no VAT is payable on that transaction. The broker number one is therefore effectively able to eliminate the economic effect of the VAT charged to it by purchasing goods of an equivalent value from the EU. HMRC will only become aware of the fraud when broker number two or another innocent party down the supply chain submits a claim for a refund of input tax (Out-Law.com, 2017).

3. LEGAL MECHANISMS IN COMBATING MTIC FRAUD

When discussing legal mechanisms in combating MTIC fraud, some authors were pointing to improving the performance of tax inspections, cooperation between tax authorities in different Member States and imposing liability on persons participating in frauds and refusal of VAT deduction (Podlipnik, 2012, p. 465). Though respecting the previous, we would emphasize difference between administrative and criminal liability and the great importance of cooperation in information exchanges.

3.1. Organisations, institutions and networks for combating tax fraud

Organization for Economic Co-operation and Development known as The OECD promoted since its occurrence in 1960 policies with an aim to improve the economic and social well-being of people around the world. One of the important issues in its work is financial stability of its members and in that way research of tax avoidance and tax evasion in the context of social security (OECD, 2017). It has now 34 member countries, works closely with more than 100 countries and operates with the budget of 370 million euro.

Eurofisc is a network for the swift exchange of targeted information between Member States established by *Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax* in order to promote and facilitate multilateral cooperation in the fight against VAT fraud. Establishment of the common system for cooperation particularly concerned exchange of information, whereby the Member States' competent authorities were to assist each other and to cooperate with the Commission in order to ensure the proper application of VAT on supplies of goods and

services, intra-Community acquisition of goods and importation of goods. For the purposes of collecting the tax owed, Member States ought to cooperate to help ensure that VAT is correctly assessed. They must therefore not only monitor the correct application of tax owed in their own territory, but should also provide assistance to other Member States for ensuring the correct application of tax relating to activity carried out on their own territory but owed in another Member State (see *Commission implementing Regulation (EU) No 79/2012 of 31 January 2012 laying down detailed rules for implementing certain provisions of Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax*). So, it is an early-warning system facilitating the exchange of information on fraudulent operators or operators suspected of fraud. Its "trademark" is the new quality of information exchange: within the network, information is not shared bilaterally, but on a multilateral basis (Joint report, 2015, p. 27). ***FIUs network*** concerns financial intelligence cooperation within the European Union. It was created by the *Council of Europe decision 2000/642/JAI concerning arrangements for cooperation between Member States financial intelligence units in respect of exchanging information*, in order to give the European Union members a safe and decentralized network, to allow the operational data exchange between all Units. Great contribution to effective combating VAT fraud present a ***Quick Reaction Mechanism against VAT fraud***. Namely, *Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud* prescribed that a Member State may, in cases of imperative urgency designate the recipient as the person liable to pay VAT on specific supplies of goods and services by derogation from Article 193 as a Quick Reaction Mechanism ("QRM") special measure to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses.

Europol was set up by *Council Decision 2009/371/JHA* as an entity of the European Union funded from the general budget of the Union to support and strengthen action by competent authorities of the Member States and their mutual cooperation in preventing and combating organised crime, terrorism and other forms of serious crime affecting two or more Member States (Sokanović, 2015, pp. 412-414). Council Decision was replaced with *Regulation (EU) 2016/794 of the European Parliament and of the Council of 11 May 2016 on the European Union Agency for Law Enforcement Cooperation (Europol) and replacing and repealing Council Decisions 2009/371/JHA, 2009/934/JHA, 2009/936/JHA and 2009/968/JHA*, but the main objectives and tasks remained the same.

According to the *Regulation (EU, EURATOM) No 883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) and repealing Regulation (EC) No 1073/1999 of the European Parliament and of the Council and Council Regulation (Euratom) No 1074/1999*, the task of ***OLAF*** is to provide the Member States with assistance from the Commission in organising close and regular cooperation between their competent authorities in order to coordinate their action aimed at protecting the financial interests of the Union against fraud. Furthermore, the Office contributes to the design and development of methods of preventing and combating fraud, corruption and any other illegal activity affecting the financial interests of the Union; promotes and coordinates, with and among the Member States, the sharing of operational experience and best procedural practices in the field of the protection of the financial interests of the Union, and supports joint anti-fraud actions undertaken by Member States on a voluntary basis. Financial interests of the Union include revenues, expenditures and assets covered by the budget of the European Union and those covered by the budgets of the

institutions, bodies, offices and agencies and the budgets managed and monitored by them (Art. 2).

The latest changes in legal framework of OLAF refers to *Regulation (EU, Euratom) 2016/2030 of the European Parliament and of the Council of 26 October 2016 amending Regulation (EU, Euratom) No 883/2013, as regards the secretariat of the Supervisory Committee of the European Anti-Fraud Office (OLAF).*

The tasks of the ***Eurojust*** are support and strengthen coordination and cooperation between national investigating and prosecuting authorities in relation to serious crime affecting two or more Member States, or requiring a prosecution on common basis, on the basis of operations conducted and information supplied by the Member States and by Europol (Sokanović, 2015, p. 148).

3.2. What about Croatia?

In most of the cases, MTIC fraud will be subsumed under Art 256 of the Croatian Criminal Code that presents criminal offence: Evasion of taxes or customs. This offence is committed by whoever, with an aim that he or another person evades wholly or in part payment of tax or customs, furnishes false or incomplete data about income, or items or other facts relevant for the assessment of tax or custom obligation or whoever with the same aim, in the case of mandatory application, does not report income, item or other facts relevant for the assessment of the tax or custom obligation, and therefore causes decrease or failure to determine tax or custom obligation in amount that exceeds twenty thousand Kuna. The prescribed penalty is imprisonment for six months to five years. The same penalty is provided for the person who uses tax or custom benefit in amount that exceeds twenty thousand Kuna against conditions under which they where gained. Qualified form of the offence is committed when the object of the perpetrator is tax or custom obligation of large scale (more than six hundred thousand Kuna). The penalty prescribed for the qualified form of the offence is imprisonment for one to ten years. Funds and means of European Union are protected in the same manner as Croatian.

As MTIC frauds imply organized crime, very important legal provisions are Art 328 and 329 of the Criminal Code. Namely, due to Art 328 Para 4, criminal association is made of at least three persons gathered with the mutual aim to commit one or more criminal offences that can be punished by imprisonment for three years or more. Persons who are incidentally gathered for directly committing one criminal offence do not fall under the scope of this definition. Evasion of taxes or custom committed by criminal association will be additional qualified form of the offence, punishable according Art 329 by severe penalties (imprisonment).

Tax Administration of the Croatian Ministry of Finance has in 2015 informed publicity about the danger of the MTIC frauds. In its publication, it issued a notice containing additional list of checks to be made to detect fraud and specially emphasized that ignorance of the business partners will not be accepted as an excuse for damages and criminal liability (Tax Administration, 2015). Tax Administration further estimated the damages for Croatia caused by MTIC fraud, especially Carousel fraud at five billion Kuna annual loss.

4. EXTRACTS FROM CASE-LAW

4.1. Kittel and Recolta Recycling Case

Ang Computime Belgium bought and resold computer components and Mr Kittel was its receiver. The Belgium tax authorities decided that the firm had knowingly participated in a carousel fraud and that supplies affected to it were fictitious. As a result, they refused to

allow the firm the right to deduct the VAT paid on those supplies. Recolta bought luxury vehicles, the relevant seller did not account for the VAT paid by Recolta, which resold the vehicles free of VAT. An investigation showed that both parties selling to Recolta and purchasing from it had set up a carousel fraud, of which the transactions with Recolta formed part. Recolta was issued with demand for payment (Podlipnik, 2012, p. 468). In this case the ECJ held that where it is ascertained, having regard to objective factors, that the trader knew or should have known that, by his purchase, he was participating in a transaction connected with VAT fraud, he can be refused his entitlement to the right to deduct VAT. However, the Court said that traders would not risk losing the right to deduct VAT paid where they "take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud" (House of Lords, European Union Committee, 2006, p. 15). A taxable person who knew or should have known that through his purchase he was taking part in transactions connected with the fraudulent evasion of VAT must be regarded as a participant in the fraud, irrespective of whether or not he profited through the resale of the goods. In such situations, the taxable person aids the perpetrators of the fraud and becomes their accomplice (§ 56, 57).

4.2. Taricco Case

Criminal proceedings have been brought in Italy against Mr Ivo Taricco and other individuals charged with having formed and organised, between 2005 and 2009, a criminal conspiracy in which they put in place fraudulent "VAT carousel" legal arrangements. Through the use of shell companies and false documents, they are alleged to have acquired bottles of champagne VAT free. This allowed the company Planet to procure those bottles at costs below the market price, thereby distorting the market. Planet is alleged to have taken receipt of invoices issued by shell companies for non-existent transactions. Those companies did not submit any annual VAT returns or, where they did submit returns, did not actually pay the corresponding VAT. Planet, on the other hand, entered the invoices issued by the shell companies in its accounts; wrongfully deducting the VAT recorded in each of them, and, consequently, submitted fraudulent annual VAT returns (CURIA, 2015). The Court (Grand Chamber) ruled as follows: A national rule in relation to limitation periods for criminal offences such as that laid down by the last subparagraph of Article 160 of the Penal Code, as amended by Law No 251 of 5 December 2005, read in conjunction with Article 161 of that Code — which provided, at the material time in the main proceedings, that the interruption of criminal proceedings concerning serious fraud in relation to value added tax had the effect of extending the limitation period by only a quarter of its initial duration — is liable to have an adverse effect on fulfilment of the Member States' obligations under Article 325(1) and (2) TFEU if that national rule prevents the imposition of effective and dissuasive penalties in a significant number of cases of serious fraud affecting the financial interests of the European Union, or provides for longer limitation periods in respect of cases of fraud affecting the financial interests of the Member State concerned than in respect of those affecting the financial interests of the European Union, which it is for the national court to verify. The national court must give full effect to Article 325(1) and (2) TFEU, if need be by disapplying the provisions of national law the effect of which would be to prevent the Member State concerned from fulfilling its obligations under Article 325(1) and (2) TFEU.

5. CONCLUSION

In 2006 it was stated that Missing Trader Fraud is not a fraud against the institutions of the European Union and that it does not occur because of any mismanagement by institutions of EU, but because the fiscal authorities of the Member States get defrauded, due to the rules that they have chosen to implement for the taxation of intra-Community trade (House of

Lords, European Union Committee, 2006, p.6). Though the explanation is rational and true, the fact is that MTIC fraud affects the institutions of EU because it reduces the budget of EU. The current VAT system for cross-border e-commerce is complex and costly for Member States and business alike. The average annual costs of supplying goods to another EU country are estimated at 8 000 Euro. Moreover, EU business are at a competitive disadvantage, as non-EU suppliers can supply VAT-free goods to consumers in the EU under the exemption for imports of small consignments (nearly 150 million VAT free consignments were imported in 2015). The complexity of the system also makes it difficult for Member States to ensure compliance, with losses estimated at around 3 billion Euro annually (European Commission, 2016, p.5). So, the Member States should move from the existing cooperation models based on exchanging information to new models of sharing and jointly analysing information and acting together. The great jeopardy of this crime does not only derive from the high material damages caused, but from the meticulously organised and numerous perpetrators. Proactive approach of criminal law jurists in combating MTIC fraud is therefore urgent.

LITERATURE:

1. Buterin, D., Blašković, N., Ribarić Aidone, E., (2014), *Suzbijanje kružnih prijevara u cilju zaštite javnih financija Hrvatske*, Zbornik Veleučilišta u Rijeci, 2(1), pp. 91-106.
2. Commission implementing Regulation (EU) No 79/2012 of 31 January 2012 laying down detailed rules for implementing certain provisions of Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 29, 1.2.2012.
3. Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud, OJ L 201, 26.7.2013.
4. Council of Europe decision 2000/642/JAI concerning arrangements for cooperation between Member States financial intelligence units in respect of exchanging information, OJ L 271, 24.10.2000.
5. Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010.
6. CURIA (2015), Press Release No 95/15, 8 September 2015, Judgement in Case C-105/14
7. European Commission, 2016, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT, Towards a single EU VAT area – Time to decide, Brussels, 7.4.2016, COM(2016) 148 final
8. Europol, last visited May 2017, available at: https://www.europol.europa.eu/crime-areas-and-trends/crime-areas/economic-crime/mtic-missing-trader-intra-community-fraud
9. Financial Action Task Force, Laundering the Proceeds of VAT Carousel Fraud, Paris, 2007
10. House od Lords, European Union Committee, Stopping the Carousel: Missing Trader Fraud in the EU, 20th Report of Session 2006-07, 2007, London, available at https://www.publications.parliament.uk/pa/ld200607/ldselect/ldeucom/101/101.pdf
11. Jedrzejek, C., Więckowski, J., Nowak, M., Bąk, J. (2013) *Why VAT carousel crime schemes are almost impossible to prosecute in Poland?* in The Economic Security of Business Transactions, Raczkowski, K., Schneider, F. (ed.), Chartridge, Oxford, pp. 68-88.
12. Joint cases C-439/04 and C-440/04 Axel Kittel v Belgian State and Belgian State v Recolta Recycling SPRL, Judgment of the Court (Third Chamber) of 6 July 2006.

13. Joint report of the Supreme Audit Institutions of Austria, Hungary and Germany on EUROFISC – a multilateral warning system of the Member States for combating VAT fraud, Bonn, 2 October 2015
14. Judgment of the Court (Grand Chamber) of 8 September 2015 in Case C-105/14 Ivo Taricco and Others
15. Out-Law.com, last visited May 2017, available at: https://www.out-law.com/topics/tax/tax-litigation--disputes-/missing-trader-fraud-mtic
16. OECD, last visited May 2017, available at: http://www.oecd.org/about/47747755.pdf
17. Podlipnik, J. (2012), *Missing Trader Intra-Community and Carousel VAT Frauds – ECJ and ECtHR Case Law*, CYELP, 8, pp. 457-472.
18. Regulation (EU, EURATOM) No 883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) and repealing Regulation (EC) No 1073/1999 of the European Parliament and of the Council and Council Regulation (Euratom) No 1074/1999, OJ L 248, 18.9.2013.
19. Regulation (EU) 2016/794 of the European Parliament and of the Council of 11 May 2016 on the European Union Agency for Law Enforcement Cooperation (Europol) and replacing and repealing Council Decisions 2009/371/JHA, 2009/934/JHA, 2009/936/JHA and 2009/968/JHA, OJ L 135/64, 24.5.2016.
20. Regulation (EU, Euratom) 2016/2030 of the European Parliament and of the Council of 26 October 2016 amending Regulation (EU, Euratom) No 883/2013, as regards the secretariat of the Supervisory Committee of the European Anti-Fraud Office (OLAF), OJ L 317, 23.11.2016.
21. Sokanović, L., 2015, Subsidy fraud in protection of financial interests of European Union: achievements and challenges, Journal of Eastern-European Criminal Law, 2(2), pp. 142-152
22. Sokanović, L., 2015., Protection of the data confidentiality in the context of criminal protection of the financial interests of the European Union, *Collected Papers of the Law Faculty of the University of Split* of the scientific-expert meeting with international participation "Right to access to information and protection of the personal data", pp. 397-418.
23. Tax Administration, 2015, available at:
24. https://www.porezna-uprava.hr/PdviEu/Obrasci/PDV%20prijevare-%20upozorenje/Kako%20uo%C4%8Diti%20prijevare%20i%20priminakne%20zloupora be%20sustava%20PDV_a.pdf

THE LEGAL NATURE AND STATUS OF INTERPOL IN THE CONTEXT OF CONTEMPORARY INTERNATIONAL LAW

Ljubo Runjic
Polytechnic of Sibenik, Croatia
runjic@vus.hr

ABSTRACT

In the international legal order exist organizations about whose legal nature there is no agreement neither in international legal doctrine nor in practice. According to the understanding of the respective authors, these organizations are classified among intergovernmental organizations or among international non-governmental organizations, and in certain cases their nature is determined as sui generis. A similar approach we can find in international practice which further confirms existing attitudes in international legal doctrine. INTERPOL represents one of these organizations which are due to their specific characteristics on the border which according to the traditional understanding divides intergovernmental organizations and international non-governmental organizations. The paper indicates that the previous mentioned dichotomy is unjustified, arguing that with the existence of a new kind of international organisms – transgovernmental organizations which gather exclusively organs of the central government in its membership. Accordingly, the paper analyzes the constituent elements of INTERPOL with the aim of proving its transgovernmental nature. Furthemore, through its participation in international relations INTERPOL has become the holder of certain rights and obligations in the international legal order, and thus acquired international legal capacity (capacitas iuridica) – a necessary constituent element of the international legal personality. Moreover, with the factual exercise of certain rights and obligations in the international legal order, such as right of concluding the treaties and the right of legation, INTERPOL has achieved the capacity to produce legal consequences on its own (capacitas agendi)- the second constitutive element of the international legal personality. Precisely for this reason, the paper discusses the rights and obligations of INTERPOL in the international legal order and thereby gives an answer to the question of its legal status in contemporary international law.

Keywords: *international legal personality, international organisms, INTERPOL, transgovernmental organizations*

1. INTRODUCTION

International legal order has developed alongside with the development of international relations, and its rules regulate precisely those international relations. The international community, i.e. its members – subjects of international law, governed by joint needs and interests – thus created international law whose rules, in turn, created its own subjects – members of the international community. The primary driving force of this circular process was the joint need and interest of the international community to regulate mutual relations by the rules of international law. Due to this, strong mutual connections and existential interdependence of the international community and international law came to the fore, confirming to the fact that law can exist only in a society, and a society cannot exists without law – *ubi societas, ibi ius.*[1] It can be noticed that, in the time frame of this relationship,

[1] Thus Brierly (1960, p. 42) points out: "Law can only exist in a society, and there can be no society without a system of law to regulate the relations of its members with one another. If then we speak of the 'law of nations', we are assuming that a 'society' of nations exists…" A similar view is presented by Shaw (2014, p. 1): "Every

depending on the needs of the international community, certain entities were granted rights and duties by the international legal order, thus becoming subjects of international law which are different in their nature and in the extent of those rights. This has been recognized by the International Court of Justice (I.C.J. Reports 1949, p. 178), whose advisory opinion from 1949 points: "The subjects of law in any legal system are not necessarily identical in their nature or in the extent of their rights, and their nature depends upon the needs of the community. Throughout its history, the development of international law has been influenced by the requirements of international life..." Thus international organisms also became a part of this diversity, determined by the needs of the international community at a certain point in time.

The prevailing viewpoint in both current international legal doctrine and practice is the one which advocates a dichotomy of international organisms, classifying them into international (intergovernmental) organizations and international non-governmental organizations. At the same time, there are still organizations within the international legal order about whose nature, i.e. classification into intergovernmental or international non-governmental organizations no general agreement has been reached in neither international legal doctrine nor in international practice. Consequently, such entities continue to exists in an "indefinite" position and are classified as intergovernmental organizations or international non-governmental organizations, depending on individual views, while sometimes their nature is determined as *sui generis*. One of the entities with such indefinite position is INTERPOL. Precisely for this reason, the first part of this paper focuses on defining the legal nature of INTERPOL and distinguishes it from similar entities in international legal order. The second part of the paper focuses on the issue of INTERPOL's status in the international legal order, seen that, by entering international relations, INTERPOL has undoubtedly become a part of the said order. In any legal order, including the international legal order, there are certain entities which possess rights and duties enforceable at law (Shaw, 2014, p. 142). Once they become bearers of rights and duties in accordance with the rules of international law, the entities acquire the status of subjects of international law, i.e. they become international legal persons (Jennings, Watts, 1992, p. 119; Degan, 2011, p. 205; Nijman, 2004, p. 3). Without an international legal personality, i.e. without rights and duties under international law, the entities cannot operate in accordance with the rules of international law nor be subject to international legal order – in a word, they cannot exist as subjects in international law[2]. Nonetheless, as the International Court of Justice rightly observed back in 1949, not all subjects of international law possess the same extent of rights and duties in the international legal order. Therefore, the aim of this paper is to provide an answer to the question of the extent of rights and duties of INTERPOL, i.e. of its status in the international legal order.

2. LEGAL NATURE OF INTERPOL

One of the consequences of the development of contemporary international relations was the emergence of international organisms – institutionalized forms of international cooperation which possess legal personality that is separate from the personality of their members.[3]

society, whether it be large or small, powerful or weak has created for itself a framework of principles within which to develop." See also Klabbers (2009, p. 1).

[2] The importance of international legal personality in international law is emphasised by numerous authors. Thus Klabbers (2005, p. 2) highlights the traditional viewpoint in the international legal doctrine according to which: "Without legal personality, so the implication goes, those entities do not exist in law, and accordingly cannot perform the sort of legal acts that would be recognized by that legal system, nor even be held responsible under international law."; whereas Nijman (2004, p. 12) emphasizes: "For altough in both theory and practice the consensus is that ILP (International Legal Personality) is one of fundamentals of international law…"

[3] The temporal dimension of international legal subjectivity has been observed by numerous authors. Feldman, (1985, p. 357) thus, points out: "It should be repeated that historico-comparative analysis has proved that

However, if we analyse the existing international organisms, we will notice that they are both mutually connected and distinguished by their constitutive elements. On the one hand, the possession of the same constitutive elements such as, for example, permanent organs and a legal personality which is separate from that of their members allows us to classify them as international organisms. On the other hand, however, specific differences which occur in some constitutive elements allow us to distinguish specific types of international organisms. For the purpose of this paper, their membership structure was used as the primary criterion for distinguishing specific types of international organisms, seen that it is precisely the membership, i.e. the membership's interests, that define the nature of each organism. Consequently, according to the membership structure, international organisms can be distinguished into international (intergovernmental) organizations (IGOs); transgovernmental organizations (TGOs); interregional organizations (IROs); and international non-governmental organizations (NGOs). Thus, intergovernmental organizations are primarily composed of sovereign states, as well as of other public legal persons of international law (e.g. other intergovernmental organizations, non-self-governing territories, the Holy See). The membership of transgovernmental organizations and interregional organizations consists of public legal persons of the national law, whereby membership of transgovernmental organizations consists of organs of the central government (e.g. the parliaments, ministries). The membership of interregional organizations, however, primarily consists of "regions" – local and regional units of different states. Finally, membership of international non-governmental organizations consists of private legal persons of international and national law (e.g. other international non-governmental organizations, non-governmental organizations, and individuals). In accordance with the aforementioned classification of international organisms, we shall try to define the legal nature of INTERPOL, and at the same time distinguish it from similar entities in international legal order. INTERPOL was founded in 1923 as the International Criminal Police Commission (ICPC), and over the years it has evolved into the International Criminal Police Organization – INTERPOL, whose aim is to ensure and promote international criminal police cooperation, as well as to establish and develop institutions which will contribute to the prevention and suppression of crimes which are not political, military, religious or ratial in nature (Articles 1, 2 and 3 of INTERPOL's Constitution).[4] Its membership, composed of national police forces, as well as the fact that it was not established by treaty, were a sufficient argument for some authors to refuse to classify INTERPOL as an intergovernmental organization, and to classify it as an international non-governmental organization instead. Thus, Schermers refused to classify INTERPOL as an intergovernmental organization, acknowledging the fact that, with regard to its membership composed of police bodies, INTERPOL was at a "dividing line" between governmental and non-governmental organizations, and precisely because of the fact that INTERPOL was not established by treaty, he classified it as an international non-governmental organization (Schermers, 1995, p. 1321). Moreover, certain authors believe that, considering the fact that it is not an intergovernmental organization, INTERPOL cannot be a subject of international law.[5] However, in the international legal doctrine there is also the "other side" which disagrees with those authors who classify INTERPOL as an international non-governmental organization.

international legal relations of each stage of historical development had their specific countenance and particular international personality." Similar claims are presented by Degan (2011, p. 219): "The circle and type of subjects of international law are subject to change over time."

[4] Constitution of the International Criminal Police Organization-INTERPOL. Retrieved 22. 4. 2017. from http://www.interpol.int/About-INTERPOL/Legal-materials/Fundamental-texts.

[5] "Interpol is not an international organization. It is therefore not a subject of international law and has no jurisdiction of its own." Gallas (1995, p. 1414)

On the contrary, they clearly define INTERPOL as an intergovernmental organization. While some authors, like Osmańczyk,[6] only briefly classify INTERPOL as an intergovernmental organization, others however seek evidence in both the constitutive elements of INTERPOL and in international practice that would support its classification as an intergovernmental organization (Rutsel Silvestre, 2010, pp. 22-23, 138-154; Schermers, Blokker, 2003, pp. 29-30). Thus, Gless (2012, p. 257) points out that INTERPOL is usually considered as a *de facto* intergovernmental organization, although its status still remains unclear.

Our search for the answer to the question of the legal nature of INTERPOL shall begin with an analysis of INTERPOL's constitutive elements, which will be compared with constitutive elements of intergovernmental and international non-governmental organizations.

When we compare the constitutive elements of INTERPOL with constitutive elements of intergovernmental organizations, we can observe that INTERPOL was not established by treaty. Instead of a treaty, which represents a constitutive act – "the constitution" – of intergovernmental organizations, INTERPOL has Constitution, adopted by its General Assembly, which is not a treaty. However, establishment by treaty does not represent a *condicio sine qua non* for the existence of an intergovernmental organization, considering the fact that exceptions from this rule can be encountered in international practice.

Membership of INTERPOL represents its most controversial constitutive element, and it is the main point of discord for the majority of authors. According to the Article 4, Paragraph 1 of INTERPOL's Constitution, its membership consists of "official police bodies" whose functions come within the framework of INTERPOL's activities.[7] It is precisely because of this article that many authors believe that INTERPOL is not an intergovernmental organization, and classify it instead as an international non-governmental organization (Scheptycki, 2004, p. 119). Gallas (1995, p. 1414) believes that INTERPOL is not an intergovernmental organization due to the fact that neither states nor their governments can become members of INTERPOL, whose membership is limited to police authorities only. Schermers, however, believed that a membership composed of private individuals confirms INTERPOL's status as an international non-governmental organization (Rutsel Silvestre, 2010, p. 151). Similar opinions were presented during discussions about the legal position of INTERPOL in the United Nations Economic and Social Council, when it was emphasized that INTERPOL was a "private organization of police officers" (Fooner, 1989, pp. 45-47). However, on the basis of the interpretation of the Article 4 of INTERPOL's Constitution we can state that membership of INTERPOL is formally composed of public legal persons of national law, i.e. of organs of the central government – official police bodies.

Precisely on the basis of this constitutive element INTERPOL can be distinguished from intergovernmental organizations – whose membership is composed of public legal persons of international law – and defined as a transgovernmental organization whose membership is composed of organs of the central government. On the other hand, the public legal nature of INTERPOL's membership allows us to distinguish it from international non-governmental organizations, considering the fact that it is precisely the non-governmental nature of its membership and activities that represents an essential constitutive element of international non-governmental organizations.

Among the constitutive elements of INTERPOL there are two which are common to both intergovernmental organizations and international non-governmental organizations – permanent organs and legal personality which is separate from that of its members.

[6] "INTERPOL is intergovernmental organization" Osmańczyk (2003, p. 1102). Similarly also in *Yearbook of International Organizations* (2003/2004, p. 1528): "Interpol currently functions as an intergovernmental organization."

[7] Article 4 of INTERPOL's Constitution provides: "Any country may delegate as a Member to the Organization any official police body whose functions come within the framework of activities of the Organization."

While INTERPOL's Constitution regulates its institutional structure, the acquisition of legal personality of INTERPOL in the internal legal order of member states is generally regulated by national legislation in each of the states (e.g. by the legislation of the United States of America),[8] or by headquarters agreement (e.g. the Agreement with France regarding INTERPOL's Headquarters in France),[9] while the international legal personality of INTERPOL is the result of the actual exercise, i.e. assumption of rights and duties in international legal order.

Based on the presented overview of the constitutive elements of INTERPOL, we can state that INTERPOL does not possess two essential constitutive elements of intergovernmental organizations – establishment by treaty, and membership composed of public legal persons of international law. Seen that there are some intergovernmental organizations which have been established without a treaty, it is precisely the membership composed of public legal persons of international law, which is without exception common to all intergovernmental organizations, that represents the criterion which distinguishes INTERPOL from intergovernmental organizations. However, due to the fact that INTERPOL's membership is composed of official police bodies, INTERPOL can be classified as a transgovernmental organization whose membership is composed of organs of the central government. On the other hand, however, the aforementioned public legal nature of INTERPOL's membership allows us to distinguish it from international non-governmental organizations.

3. STATUS OF INTERPOL IN INTERNATIONAL LEGAL ORDER

Who is a subject of international law, i.e. who is an international legal person, is one of the fundamental and most controversial issues of international law.[10] The answer to this question is to be sought at the very heart of international law, where subjects of international law represent both the starting point and the end point of international law. Moreover, to this day no single definition of a subject of international law has been adopted at the level of positive international law, delegating the definition of this concept to the international legal doctrine. The cause for this can be traced back to the fact that the dynamics of international relations is driven by the needs of the international community at a given point in time, resulting in the emergence of a wide range of different subjects of international law. Consequently, international legal subjectivity is a relative concept which varies from one subject of international law to another.[11]

[8] See: Executive Order 12425 of June 16, 1983, International Criminal Police Organizations, *Federal Register*, vol. 48, 1983.

[9] Article 2 of the Agreement between INTERPOL and France on INTERPOL's headquarters in France provides: "The Government of the French Republic recognizes the Organization's legal personality and, in particular, its capacity to:
a) enter into contracts;
b) acquire and dispose of movable and immovable property connected with its activities;
c) be party to judicial proceedings." Retrieved 24. 4. 2017. from http://www.interpol.int/About-INTERPOL/Legal-materials/Fundamental-texts.

[10] With regard to the status of different actors in international relations – states, trust territories, intergovernmental organizations, various groups of individuals – Vukas (1991, p. 483) asks the following question: "There is a permanent query: which of these entities are subjects of international law, that is, who possesses legal personality under international law?", whereas, with regard to the issue of international legal personality of the United Nations, the 1949 advisory opinion of the International Court on *Reparation for injuries suffered in the service of the United Nations* specifies: "Does the Organization possess international personality? This is no doubt a doctrinal expression, which has sometimes given rise to controversy." (I.C.J. Reports 1949, p. 178). See also Nijman (2004, p. 4).

[11] In this sense, Dixon (2000, p. 105) points out: "The most important point about international personality is, indeed, that is not an absolute concept.", whereas Shaw (2014, p. 143) claims: "Personality is a relative phenomen varying with the circumstances."

Nonetheless, we can identify those constitutive elements of international legal subjectivity which are commonly accepted by most authors, and used to define the concept of international legal subjectivity more clearly.

Legal capacity (*capacitas iuridica*) – the capacity of possessing rights and duties in accordance with the rules of international law – represents the main constitutive element of international legal personality, i.e. its possession is a *condicio sine qua non* for an entity to be considered as a subject of international law, or an international legal person (Vukas, 1991, p. 491). Not all entities in the international legal order have the same extent of legal capacity. International legal order is the one which, depending on the needs of the international community, determines the extent of rights and duties of its subjects. It is precisely for this reason that the extent of legal capacity of a subject of international law depends on its function in the international community (Mosler, 2010, p. 713).

The capacity of an entity to produce legal consequences on its own (*capacitas agendi*) is another constitutive, although not mandatory element of international legal personality. *Capacitas agendi* occurs as the consequence of a previously acquired legal capacity, i.e. ultimately of the previously acquired legal presonality. Despite disagreements among authors regarding certain aspects of *capacitas agendi* in international law, it is the general consensus that the *capacitas agendi* entails the right to conclude treaties, *ius legationis*, the capacity to litigate before international judicial and quasi-judicial institutions, the right to convene and participate in international conferences, the capacity to create international law and, in classical international law, the righ to war as well. Apart from this, *capacitas agendi* also encompasses delictual capacity. Similarly to the extent of legal capacity, not all entities in international legal order have the same extent of *capacitas agendi*. On the contrary, the extent of *capacitas agendi* of a subject of international law is also defined by its function in the international community and by the needs of that community.

Considering the fact that the issue of international legal subjectivity of INTERPOL remains on the margins of doctrine-related debates, we shall look for the answer primarily in the international legal order itself, as well as in international practice. First of all, INTERPOL has achieved the right to conclude treaties (*ius contrahendi*). This right is one of the most important elements of international legal personality of international organisms, although it might be more correct to say that the right to conclude treaties is one of the causes for acquisition of international legal personality of international organisms. INTERPOL has thus concluded a series of treaties and agreements with various states, including those states in which it has its headquarters.[12] Moreover, INTERPOL is also a party to the Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations of 1986.[13] Also, INTERPOL has concluded numerous agreements not only with states, but with international organizations as well.[14]

Furthermore, INTERPOL has also achieved an active *ius legationis*. This is substantiated by, for example, the agreement between INTERPOL and France regarding the Headquarters of INTERPOL, whereby INTERPOL and its officials are guaranteed privileges and immunities which are to a great extent similar to diplomatic privileges and immunities enjoyed by diplomatic missions of states and their diplomatic representatives on the basis of the Vienna Convention on Diplomatic Relations of 1961. What is more, Article 17, Paragraph 1 of the Agreement between INTERPOL and France expressly provides that the Secretary General of

[12] See the list of treaties concluded between INTERPOL and various states. Retrieved 30. 4. 2017. from http://treaties.un.org/pages/UNTSOnline.aspx?id=3.

[13] Text of the Convention can be found in the Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations, *NN -MU*, n. 1, 1994.

[14] See the list of treaties concluded between INTERPOL and international organizations. Retrieved 30. 4. 2017. from http://www.interpol.int/About-INTERPOL/Legal-materials/Cooperation-agreements.

INTERPOL in France shall have the status of the head of a diplomatic mission, whereas Paragraph 2 of the same Article stipulates that INTERPOL's directors shall enjoy benefits and immunities accorded to diplomatic agents.[15] INTERPOL has concluded similar agreements with other states in which it has its headquarters – Argentina, Côte d'Ivoire, El Salvador, Cameroon, Kenya, Thailand and Zimbabwe.[16] Another proof of INTERPOL's active *ius legations* can be found in the previously mentioned Executive Order 12425 by the American president Reagan from 1983, whereby INTERPOL is guaranteed privileges, exemptions and immunities conferred by the International Organizations Immunities Act.

To a certain extent, INTERPOL has also acieved the right to convene and participate in international conferences. For example, in 1998 INTERPOL participated in the Diplomatic Conference for the Establishment of the International Criminal Court[17] as an observer, and in 1995 it participated in the Diplomatic Conference for the Adoption of the Draft UNIDROIT Convention on the International Return of Stolen or Illegally Exported Cultural Objects.[18]

INTERPOL has also achieved the capacity to litigate before international judicial entities (*ius standi in iudicio*). INTERPOL realised its right to be a party in court proceedings before an international judicial entity by submitting itself to the jurisdiction of International Labour Organization Administrative Tribunal – ILOAT[19]. Besides in court proceedings, INTERPOL has achieved its capacity to litigate before international judicial entities in arbitration proceedings as well. Article 24, Paragraph 1 of the Agreement between INTERPOL and France regarding INTERPOL's Headquarters in France thus prescribes the submission of disputes to the Permanent Court of Arbitration in The Hague.[20]

For many authors, participation in the creation of international law is one of the most important elements of international legal subjectivity (Degan, 2011, p. 205; Mosler, 2000, p. 711; Portman, 2010, p. 8). The said right has been achieved by INTERPOL, which has achieved its participation in the creation of international law through two main modes of its

[15] "1. In addition to the privileges and immunities granted by Article 17, the Secretary General shall have the status of the head of a diplomatic mission.
2. The Directors at the Organization's General Secretariat in France shall be granted, for the duration of their functions, the privileges and immunities accorded to diplomatic agents." For the text of the Agreement see: *supra*, n. 9.

[16] See the list of INTERPOL's agreements regarding headquarters. Retrieved 30. 4. 2017. from https://secure.interpol. int/Public/ICPO/LegalMaterials/constitution/hqagreement/Default.asp.

[17] See the Final Act of the United Nations Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court from 1998, whose Annex III provides the list of international organizations and other entities which have participated in the conference as observers. INTERPOL is also featured on the said list. For the text of the Annex, see: United Nations Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court, Rome, 15 June - 17 July 1998, Official Records, Volume I, Final documents **(**U.N. Doc. A/CONF.183/10), pp. 65-79.

[18] See the list of participants of the Diplomatic Conference for the Adoption of the Draft UNIDROIT Convention on International Return of Stolen or Illegaly Exported Cultural Objects which, among others, also features INTERPOL. For the list of the participants, see: Diplomatic Conference for the Adoption of the Draft UNIDROIT Convention on the International Return of Stolen or Illegally Exported Cultural Objects: Acts and Proceedings, pp. 48-65. Retrieved 30. 4. 2017. from http://www.unidroit.org/english/conventions/1995culturalp roper ty/1995culturalproperty-acts-e.pdf

[19] See the list of international organisms which have recognized the jurisdiction of ILOAT. Retrieved 2. 5. 2017. from http://www.ilo.org/public/english/tribunal/membership/index.htm.

[20] Article 24, Paragraph 1 of the Agreement between INTERPOL and France: "Unless the Parties in the dispute decide otherwise, any dispute between the Organization and a private party shall be settled in accordance with the Optional Rules for Arbitration between International Organizations and Private Parties of the Permanent Court of Arbitration by a tribunal composed either of one or of three members appointed by the Secretary General of the Permanent Court of Arbitration. Either party may however request the Secretary General of the Permanent Court of Arbitration to establish such a tribunal immediately to examine a request for provisional measures to ensure that its rights are protected." For the text of the Agreement, see: *supra*, n. 9.

creation – treaties and customs. In addition to the immediate conclusion of treaties (e.g. the aforementioned agreements regarding headquarters), INTERPOL has ensured its participation in international legislation process indirectly through states concluding multilateral treaties at international (diplomatic) conferences. An example thereof is INTERPOL's participation as an observer at the Diplomatic Conference on the Establishment of the International Criminal Law Tribunal. Even though participation in the work of an international conference in the capacity of an observer does not entail the right to participate in the decision-making process at the conference, its committees or subsidiary bodies, the influence of the observer on the adoption of conventions frequently surpassed its formal observer status. Observers may achieve considerable influence on international legislation process by actively participating in the organisation of conferences, proposing draft conventions or some parts thereof, by participating in discussions and by inviting independent experts. In addition to treaties, INTERPOL has achieved its participation in the creation of international law through international customary process as well, i.e. through both elements necessary for the creation of customary law – general practice and legal consciousness (*opinio iuris*). Moreover, it is precisely in specific resolutions of INTERPOL's General Assembly, such as the 2003 Rules on the Processing of Information for the Purposes of International Police Cooperation[21], or the 2011 Rules on the Processing of Information[22], that we find the so-called *soft law* (Schöndorf-Haubold, 2008, p. 1733), whose purpose is to affect the actions of subjects of international law, but in regard of which there is no clear willingness of the states to be the source of their rights and obligations (Andrassy, Bakotić, Seršić, Vukas, 2010, p. 31).

Finally, INTERPOL has also achieved delictual capacity. The notion of delictual capacity in international law entails the capacity of a subject of international law to violate an international legal obligation, i.e. to commit an internationally wrongful act resulting in its own international liability. In fact, the consequence (or, in reality, the cause) of international legal capacity of international organisms is the possession of rights and obligations pursuant to international law. The possession of said obligations in conformity with international law has as a necessary consequence the international legal responsibility of international organisms, since every legal norm in international law, including the one imposing a certain obligation, may be violated in theory.[23]

4. CONCLUSION

The analysis of constitutive elements of INTERPOL has confirmed the hypothesis presented at the begining of this paper on the unjustified classification of international organisms into international (intergovernmental) organizations and international non-governmental organizations. Moreover, it is precisely INTERPOL, whose membership is composed of public legal persons of national law – organs of the central government, that serves as a proof of the existence of a new type of international organisms which we have defined as transgovernmental organizations. Apart from defining the legal nature of INTERPOL, i.e. classifying it as a transgovernmental organization and simultaneously distinguishing it from similar entities – intergovernmental and international non-governmental organizations, this paper provides the answer to the question of INTERPOL's status in international legal order. Having acquired the rights and duties in accordance with the rules of international law,

[21] See: Resolution AG-2003-RES-04.

[22] See: Resolution AG-2011-RES-07.

[23] Shaw (2014, p. 950) points out: "Responsibility is a necessary consequence of international personality and the resulting possession of international rights and duties.". Similarly and Bowett: "Liability is thus generally presented as the logical corollary of the powers and rights conferred upon international organisations." (Sands, Klein, 2009, p. 518)

INTERPOL has achieved international legal capacity, and consequently also an international legal personality.

In other words, INTERPOL has become a subject of international law. INTERPOL has also achieved *capacitas agendi* – the second constitutive element of international legal personality. This can be substantiated by INTERPOL's achievement of the right to conclude treaties, achievement of an active *ius legations*, partial achievement of the right to convene and participate in international conferences, achievement of the capacity to litigate before international judicial institutions, participation in the creation of international law, and delictual capacity under international law.

LITERATURE:

1. Agreement between the International Criminal Police Organization-INTERPOL and the Government of the French Republic regarding INTERPOL'S Headquarters in France. Retrieved 24. 4. 2017. from http://www.interpol.int/About-INTERPOL/Legal-materials/ Fundamental-texts.
2. Andrassy, J., Bakotić, B., Seršić, M., Vukas, B. (2010). *Međunarodno pravo 1* (2nd edn.). Zagreb: Školska knjiga
3. Brierly, J.L. (1960). *The Law of Nations*. New York, Oxford: Oxford University Press.
4. Constitution of the International Criminal Police Organization-INTERPOL. Retrieved 22. 4. 2017. from http://www.interpol.int/About-INTERPOL/Legal-materials/Fundamental-texts.
5. Degan, V.Đ. (2011). *Međunarodno pravo*. Zagreb: Školska knjiga.
6. Diplomatic Conference for the Adoption of the Draft UNIDROIT Convention on the International Return of Stolen or Illegally Exported Cultural Objects: Acts and Proceedings. Retrieved 30. 4. 2017. from http://www.unidroit.org/english/conventions/19 95culturalp roper ty/1995culturalproperty-acts-e.pdf
7. Dixon, M. (2000). *Textbook on International Law*. Oxford: Oxford University Press.
8. Executive Order 12425 of June 16, 1983, International Criminal Police Organizations, *Federal Register*, vol. 48, 1983.
9. Feldman, D. (1985). International personality. *Recueil des cours de l'Académie de droit international de La Haye*, vol. 191.
10. Fooner, M. (1989). *INTERPOL-Issues of World Crime and International Criminal Justice*, New York: Springer.
11. Gallas, A. (1995). INTERPOL. In: R. Bernhardt (ed.), *Encyclopedia of Public International Law*, vol. 2. Amsterdam, Lausanne, New York, Oxford, Shannon, Tokyo: North-Holland Elsevier.
12. General Cooperation Agreement between the General Secretariat of the International Criminal Police Organization-INTERPOL and the General Secretariat of the Organization of American States. Retrieved 27. 4. 2017. from http://www.interpol.int/About-INTERPOL/Legal-materials /International-Cooperation-Agreements.
13. Gless, S. (2012). Interpol. In: R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, vol. VI. Oxford: Oxford University Press.
14. Jennings, R. Sir, Watts, A. Sir. (1992). *Oppenheim's International Law*, vol. I. Harlow: Longman.
15. Klabbers, J. (2005). The Concept of Legal Personality. *Ius Gentium*. vol. 11.
16. Klabbers, J. (2009). *An Introduction to International Institutional Law* (2nd edn.). Cambridge: Cambridge Univeristy Press.
17. Mosler, H. (2000). Subjects of International Law. In R. Bernhardt (ed.), *EPIL*, vol. 4. Amsterdam, London, New York, Oxford, Paris, Shannon, Tokyo: North-Holland Elsevier.

18. Nijman, J.E. (2004). *The Concept of International Legal Personality: An Inquiry Into the History and Theory of International Law*. The Hague: T.M.C. Asser Press.
19. Osmańczyk, E.J. (2003). *Encyclopedia of the United Nations and International Agreements*, vol. 2. New York, London: Routledge.
20. Portmann, R. (2010). *Legal Personality in International Law*, Cambridge: Cambridge University Press.
21. Reparation for injuries suffered in the service of the United Nations, Advisory Opinion, *I.C.J. Reports* 1949.
22. Resolution AG-2003-RES-04.
23. Resolution AG-2011-RES-07.
24. Rutsel Silvestre, J.M. (2010). *The Legal Foundations of INTERPOL*, Portland: Hart Publishing.
25. Sands, P., Klein, P. (2009). *Bowett's Law of International Institutions* (6th edn.). London: Sweet & Maxwell.
26. Scheptycki, J. (2004). The Accountability of Transnational Police Institutions: The Strange Case of Interpol. *Canadian Journal of Law and Society*, vol. 19, n. 1.
27. Schermers, H.G. (1995). International organizations, membership. In: R. Bernhardt (ed.), *Encyclopedia of Public International Law*, vol. 2. Amsterdam, Lausanne, New York, Oxford, Shannon, Tokyo: North-Holland Elsevier.
28. Schermers, H.G., Blokker, N.M. (2003). *International Institutional Law*. Boston, Leiden: Martinus Nijhoff Publishers.
29. Schöndorf-Haubold, B. (2008). The Administration of Information in International Administrative Law – The Example of INTERPOL. *GYIL*, vol. 9, n. 11.
30. Shaw, M.N. (2014), *International Law* (7th edn.). Cambridge: Cambridge Univerisity Press.
31. Union of International Associations (2003/2004). *Yearbook of International Organizations*, vol. 1. Munchen: K.G. Saur Verlag.
32. United Nations Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court, Rome, 15 June - 17 July 1998, Official Records, Volume I, Final documents **(**U.N. Doc. A/CONF.183/10).
33. Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations, *NN -MU*, n. 1, 1994.
34. Vukas, B. (1991). States, Peoples and Minorities. *RCADI*, vol. 231.

RESTRUCTURING OF COMPANIES AND EMPLOYMENT SECURITY

Sandra Laleta
Faculty of Law University of Rijeka, Hahlić 6, 51000 Rijeka
sandra.laleta@pravri.hr

ABSTRACT
The restructuring of a company often results in changes to the terms and conditions of employment. Today, it is widely accepted that restructuring should be socially responsible and take into account not only employment security, but also the interests of the society as a whole. With this in mind the author analyses some measures of Croatian law that guarantee employment and job security as an alternative to dismissal, while paying special attention to atypical work.
Keywords: *atypical work, employment security, restructuring*

> "So far, I haven't seen a single company which produces great ideas while people are afraid of their future or their job."
>
> *Fred Langhammer, CEO Estée Lauder*[1]

1. INTRODUCTION

Restructuring activities within companies often cause changes to employment terms and conditions, as well as the employment status of an employee. It is commonly accepted that restructuring should be socially responsible. In the EU, the request for anticipative and proactive restructuring is promoted by the European Commission in its Communication on EU Quality Framework for anticipation of change and restructuring.[2] European directives on information and consultation of workers contributed to restructuring through the involvement of workers' representatives in the restructuring process. Three directives on collective redundancies, on transfers of undertakings and on a general framework for information and consultation of workers "generally relevant, effective, consistent and mutually reinforcing … seem to have contributed to cushioning the shock of the recession and mitigation the negative social consequences of restructuring operations during the crisis."[3] The weak points are seen in the exclusion of small enterprises, public administrations and seafarers from the scope of application of the directives. Moreover, some negative factors, such as low incidence of representative bodies and the quality of their involvement, insufficient awareness of rights and obligations contribute to a reduced effectiveness of the directives. Equally important however is the culture of social dialogue.[4] The International Labour Organization continuously highlights the importance of established minimum standards on restructuring and gives new proposals to this effect in its documents.[5]

[1] Rogovsky, N., Socially Sensitive Enterprise Restructuring (ILO/SSER) ILO, Geneva, available at: http://www.abird.info/webcontent/images/stories/materiali/seminar_20_05_2010/SSER.Bulgaria.pdf, 27.5.2017.
[2] EC, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, 13.12.2013 COM(2013) 882 final (herein: EC Communication 2013), p 4.
[3] EC Communication 2013, p 5.
[4] Loc. cit.
[5] http://www.ilo.org/empent/areas/social-responsible-enterprise-level-practices/lang--en/index.htm, 27.5.2017.

Restructuring should be done carefully in order to encompass both the economic and social dimension, i.e., it must taking into account the interests of all stakeholders, especially the employees and management, to the greatest extent possible to achieve the final aim of restructuring, namely, either promote the competitiveness of the company or enable its survival. Socially responsible restructuring takes care about employment security, on one side, and wider societal interests, on the other. The concept of employment security can be defined as "some form of regulatory intervention designed to protect workers against arbitrary managerial decision-making",[6] i.e., rules and provisions that regulate valid cause and fair procedure that restrain the employers' discretional decision to terminate the employment contract. Employment security is deeply threatened in a world of work characterized by atypical, flexible, new forms of employment that create a new class of precarious workers: precariat.[7] Instead of employment security, the notions of employability[8] and capability[9] are used. With respect of worker's rights, three levels of restructuring are discerned: first, restructuring without cutting of labour costs; second, restructuring with cutting of labour costs but without dismissals; and third, the reduction of the number of employees albeit in a socially responsible way, by using particular tools in order to help both employees and "survivors".[10] Likewise, socially responsible restructuring includes the possibility of re-employment of dismissed workers in light of the fact that every dismissal can be a new burden for the state.

In restructuring different tools are used, such as voluntary redundancies, internal and external job search help, establishment of SMEs, mobility, early retirement, vocational training, part-time work or other alternative measures designated to keep the worker employed; subcontracting, flexible leave, psychological help, severance packages etc. Since SMEs have difficulties in developing socially responsible practices on their own, they need stronger support. Publicly funded strategic arrangements and regional partnerships proved especially efficient in this regard.[11] In the last decade and a half the frequency of restructuring has increased due to the economic crisis. According to the European Restructuring Monitor, since 2002 to date there have been approximately 18.000 cases of restructuring. This statistics includes only those cases in which, due to restructuring, at least 100 positions were lost or created or it influenced the employment or employment relationship of at least 10% of employees in companies employing at least 250 workers.[12] Since cases of smaller-scale restructuring are not included, the true number is in all likelihood higher. Restructuring in the public sector is often realized through outsourcing.[13]

[6] Deakin, S., Morris, G.S. (2012), Labour Law, 6th ed., Hart Publishing, Oxford, p. 418.
[7] Standing, G. (2011), The Precariat: The New Dangerous Class, Bloomsbury Academic, London.
[8] Supiot, A. (2005), Beyond Employment (Changes in Work and the Future of Labour Law in Europe), Oxford University Press, New York, pp. 140, 210.
[9] Zimmermann, B. (2014), From Flexicurity to Capabilities, in: Destructing Flexicurity and Developing Alternative Approaches (ed. M. Keune and A. Serrano), Routledge, New York, London, p. 138; Salais, R. (2014), Labour, Capabilities and Situated Democracy, in: Destructing Flexicurity and Developing Alternative Approaches (ed. M. Keune and A. Serrano), Routledge, New York, London, p. 120.
[10] Rogovsky, N. et al. (2005), Restructuring for corporate success: A socially sensitive approach, International Labour Office, Geneva.
[11] CEDEFOP (2010), Socially responsible restructuring (Effective strategies for supporting redundant workers), Luxembourg, Publications Office of the European Union, p. 1.
[12] European Restructuring Monitor, https://www.eurofound.europa.eu/hr/observatories/european-monitoring-centre-on-change-emcc/european-restructuring-monitor, 20.5.2017.
[13] In Croatia, the reform of ancillary activities in the public sector in 2014-2015 was announced based on a single model of in-house improvement of efficiency. However, this model included the possibility of outsourcing to a great extent. Senčur-Peček, D., Laleta, S., Kraljić, S. (2017), Labour law implications of outsourcing in public sector, *Lex localis* (forthcoming).

The consequences of restructuring for workers can be dramatic, as in the case of French Telecom that was privatized in 2004 and restructured in line with the NeXT recovery plan (2006-2009). In total, 22.000 positions were abrogated and 10.000 positions modified, resulting in a number of suicides of workers affected by these changes.[14] However, such a scenario of large-scale restructuring is not one-of-a-kind in EU Member States. The recent European Parliament Resolution highlighted the importance of "more sophisticated EU outplacement rules",[15] in connection with two cases of restructuring, Caterpilar and Alstom.[16] The most recent Croatian case should be analysed in the light of this document. The case in question concerns the concern Agrokor, a multinational company that faced difficulties with liquidity because of high debts. The Croatian Government and Parliament intervened by enacting a special act, the so-called *lex Agrokor.*[17] With this Act the implementation of the Insolvency Act and other rules otherwise applicable in such situations was postponed for up to 15 months. This intervention caused an eruption of negative reactions from the scientific, professional and wider public.[18] The process of restructuring and fight for the 60.000 workers of Agrokor is inevitable. Such cases confirm the importance of preliminary rescue or restructuring plans and, even more so of the development of one or more models of restructuring. Although the latter do not exist in Croatia, there are good models in our EU neighbourhood that may be endorsed.[19] In the following sections some instruments of restructuring used in Croatia are analysed.

2. THE CROATIAN LABOUR MARKET AND RESTRUCTURING

The Croatian labour market is highly segmented, with low labour force mobility.[20] Relatively high real wages, institutional rigidity, supply and demand imbalances due to education and competencies issues account for the key obstacles to a more dynamic labour market.[21] In addition, there is a lack of normative flexibility and high taxes on labour.[22] In the last decade, the number of the employed has constantly decreased, whereas the number of unemployed increased. Croatia has a relatively low activity and employment rates, particularly for women, youth and older persons. What more, it has a high share of retired persons of working age. Despite some decreasing trends marked at the beginning of 2017, Croatia remains a country with the highest unemployment rate in the EU, amounting to 11.3 %, and with a particularly high youth unemployment rate of 43.0%. The share of long-term unemployed amounts to 58.4 %. In 2016, the employment rate was 56.9 %.

[14] The labour inspectorate criticized severely the entire restructuring process. Finally, a criminal process for "bullying and inappropriate risk assessment" was initiated, and as a result the employer was obliged to additional assessment and prevention of psychosocial risks. Eurofound and EU-OSHA (2014), Psychosocial risks in Europe: Prevalence and strategies for prevention, Publications Office of the European Union, Luxembourg, p. 62ff.

[15] Hiessl, C., Laleta, S. (2017), Implementation problems of the Collective Redundancies Directive and their consequences: the Croatian example, *Europäische Zeitschrift für Arbeitsrecht* (forthcoming).

[16] European Parliament Resolution of 5 October 2016 on the need for a European reindustrialization policy in light of the recent Caterpillar and Alstom cases (2016/2891(RSP)), http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2016-0377+0+DOC+XML+V0//EN&language=GA, 15.5.2017.

[17] Zakon o postupku izvanredne uprave u trgovačkim društvima od sistemskog značaja za Republiku Hrvatsku, Official Gazette (herein: OG), no 32/2017.

[18] E.g. http://www.jutarnji.hr/vijesti/hrvatska/pravni-strucnjaci-o-utemeljenosti-lex-agrokora-sanja-baric-zakon-krsi-europsko-pravo-i-ustav-te-otvara-put-anarhiji/5868850/, 10.5.2017

[19] CEDEFOP (2010).

[20] Bilić, A. (2011), Fleksibilnost i deregulacija u radnim odnosima (PhD thesis), Pravni fakultet, Split, p. 263

[21] Bejaković, P., Gotovac, V. (2011), Aktivnosti na gospodarskom oporavku u Republici Hrvatskoj s naglaskom na tržište rada, *Revija za socijalnu politiku*, vol. 18, no. 3, pp. 331, 340.

[22] Opinion of D. Nestić in: Sočković, K., Crgić, I. (2015), Zaposlenost mora biti prioritetni nacionalni cilj, *Privredni vjesnik*, no. 3901, 9.11.2015, p. 6.

Approximately 16 % of workers had a fixed-term contract and 86.000 workers had a part-time job or temporary job. In 2014, grey economy represented 28 % of the GDB, what is 10 % above the EU 31 average rate.[23] Restructuring within companies that includes reduction of workforce occurs often in Croatia. According to the statistics, collective redundancies involve on average 100 workers per case.[24] This has severe economic and social impact on the economy.[25] In 2015, 74 notifications of collective redundancies were made to the Croatian Employment Service, comprising 9.014 workers.[26] Compared to 2014, the number of redundancies increased by 35.8%.[27] Workers who completed secondary education were made redundant the most (51.5%), a third of them were older than 50 and more than a quarter aged 40-50. Most severely affected were workers employed in electricity, gas, steam and air-conditioning supply (33.5%) and manufacturing (29.3%), and finance, wholesale and retail trade. In the period from 2011 to 2015 there were 608 companies in insolvency proceedings and the Agency for Insurance of Workers' Claims in Case of Employer's Bankruptcy payed off 21.144 claims to workers whose employment contracts were terminated due to insolvency.[28]

Let us single out two most important issues that had a strong influence on the achievement of efficiency or socially responsible restructuring in Croatia. A serious problem is the "formal" implementation of the European directives on collective redundancies, transfer of undertakings and insolvency in the Croatian legislation.[29] Consequently, it is likely that various situations that should have been covered by the scope of the directives according to settled case law of CJEU are excluded and presumably, a large number of workers deprived of their benefits.[30] The second problem is posed by an underdeveloped social dialogue in Croatia.[31]

3. THE FLEXIBILIZATION OF THE CROATIAN LABOUR LEGISLATION AND ITS IMPACT ON EMPLOYMENT SECURITY

Under the recommendations of the IMF, European Commission and World Bank, Croatian labour legislation has been further liberalized. The Labour Act adopted in 2014[32] introduced more flexicurity.[33] Some of the introduced novelties have an impact on the process of restructuring. The employers who employ 20 and more workers ("big" employers) no longer have a duty to try to find another position for a redundant worker within the company and a duty to attempt to educate or train a worker in order to enable him work in another position within the company. It seems that cancelled duties[34] did not have a significant impact on

[23] http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics, 27.5.2017.
[24] Croatian Employment Service, Yearbook 2015, 2016, p. 55.
[25] Potočnjak, Ž. (2016), Neki problemi primjene Direktive o kolektivnom otkazivanju ugovora o radu u hrvatskom zakonodavstvu i praksi, in: Aktualnosti hrvatskog zakonodavstva i pravne prakse, 23, Organizator, Zagreb, p. 229ff.
[26] Croatian Employment Service, available at: http://statistika.hzz.hr/Statistika.aspx?tipIzvjestaja=2, 6.4.2017.
[27] Croatian Employment Service, Yearbook 2015, p. 58.
[28] http://www.aorps.hr/dokumenti-agencije/, 20.4. 2017.
[29] Potočnjak, Ž. (2016), pp. 229-277; Senčur-Peček et al. (2017); Smokvina, V. (2017), Collective Dismissal in Croatia, in: Collective Dismissal in the European Union: A Comparative Analysis (ed. R. Cosio et al.), Kluwer Law International, Alphen aan den Rijn, pp. 35-49.
[30] Hiessl, C., Laleta, S. (2017).
[31] Grgurev, I., Vukorepa, I. (2015), Uloga sindikata u doba gospodarske krize u Hrvatskoj, *Zbornik Pravnog fakulteta u Zagrebu*, vol. 65, no. 3-4, pp. 387-408
[32] *Zakon o radu*, OG, no 93/2014.
[33] See more in: Grgurev, I. (2013), Labour Law in Croatia, Kluwer Law International, Alphen aan den Rijn
[34] In a Draft proposal of the LA the Ministry of labour and pension system explained it in terms of the need to make the process of employers' restructuring faster.

protection of workers in case of dismissal[35] and a number of labour disputes in which the court has found a dismissal unlawful due to the fact that the employer did not fulfil these duties was insignificant.[36] On the other hand, they were not only a tool to avoid a dismissal, but also a tool of the implementation of the *ultima ratio* principle as the main principle of Croatian dismissal legislation, at least thus far. This "significantly undermines the social dimension of employment relationship" and means that the *ultima ratio* principle is almost abandoned.[37]

It should be highlighted that in case of economic dismissal the "big employer" still has a duty of so-called social choice, i.e. to take into account several criteria[38] in order to dismiss the worker who will be in a position to most easily bear the negative consequences of the dismissal.[39] For the dismissed worker a certain level of security represents a duty of the employer to offer the same vacant position in the company within six months after the economic dismissal to that worker was effectuated. Due to the flexible approach of the courts, this duty is just of relative importance: if the employer violates a duty, the employment contract with a new worker is valid and the dismissed worker is only entitled to indemnity.[40] The LA prescribes that the employer is responsible for a serious offence.[41]

4. TEMPORARY OUTPLACEMENT OF A WORKER TO AFFILIATED COMPANY

Temporary outplacement of a worker to affiliated company is a novelty in Croatian labour law introduced by the Labour Act (2014). According to the Art. 10 par. 3, when the employer has no need for work of specific workers, he may temporarily assign a worker to a company affiliated with him, for a maximum period of six consecutive months, based on an agreement between the affiliated employers and written consent of the worker. The notion of *an affiliated company* is defined in the Companies Act as *lex specialis*.[42]

The agreement between the affiliated employers should contain data concerning: 1) names and seats of affiliated employers, 2) full name and residence of the worker, 3) dates of commencement and termination of temporary outplacement, 4) place of work and tasks to be performed by the worker, 5) wage, bonuses and payment periods, and 6) duration of a regular working day or week.

The written worker's consent to the mentioned agreement forms an appendix to his/her employment contract, in which a fixed-term outplacement of the worker to the affiliated

[35] Potočnjak, Ž. (2015), Novine i dvojbe u svezi s otkazom i drugim načinima prestanka ugovora o radu, in: Zbornik 53. susreta pravnika Opatija. Hrvatski savez udruga pravnika u gospodarstvu, Zagreb, pp 115; Milković, D. (2014b), Novi Zakon o radu, in: Aktualnosti hrvatskog zakonodavstva i pravne prakse, 21, Organizator, Zagreb, p. 179.

[36] Milković, D. (2015), Sporna pitanja novog Zakona o radu, in: Aktualnosti hrvatskog zakonodavstva i pravne prakse, 22, Organizator, Zagreb, p. 165; Milković, D. (2014a), Članak 115, in: Detaljni komentar novoga Zakona o radu (ed. K. Rožman), Rosip, Zagreb, p. 412.

[37] Potočnjak, Ž. (2015), p. 115; Laleta, S. (2017), Individual Dismissal in Croatia, in: Transnational, European, and National Labour Relations (ed. G. G. Sander et al.), Springer Verlag, Heidelberg … [etc.] (forthcoming).

[38] The criteria are seniority of the worker, worker's age and worker's legal duties of alimentation (Art. 115 par. 2 LA).

[39] Potočnjak, Ž. (2007), Prestanak ugovora o radu, in: Radni odnosi u Republici Hrvatskoj (ed. Ž. Potočnjak), Pravni fakultet u Zagrebu, Organizator, Zagreb, p. 397ff.

[40] Supreme Court, Revr-763/07 (21.11.2007), Revr-1913/09 (8.12.2009).

[41] The prescribed fine ranges from 31.000 to 60.000 HRK that is approximately 4.150 – 8.040 Euros.

[42] "In accordance with Art. 473 CA, affiliated companies are legally independent companies that in terms of relationship may be defined as: (1) a company that has major share in the capital or in voting rights of the other company, (2) a dependent and dominant company, (3) „konzern" company, (4) companies with mutual shareholders, (5) companies affiliated with entrepreneurial agreements." Čulinović, E., Zubović, A. (2016), Cash-Settled Derivatives and Their Role in Companies' Takeovers, in: New Europe – Old Values? (Reform and Perseverance) (ed. N. Bodiroga-Vukobrat et al.), Springer, Heidelberg, pp. 235-268.

employer is stipulated. Temporary outplacement does not represent temporary agency work and therefore the provisions of LA regulating temporary agency work do not apply.
According to LA, the affiliated employer for whom the worker performs work has all the duties of the employer provided for by the LA, as well as the duties regarding safety and health at work protection, as regulated by the relevant laws and regulations.
In the Croatian literature, temporary outplacement to the affiliated company is considered *ad hoc* employee sharing.[43] According to the Eurofound's classification, *ad hoc* employee sharing is one type of employee sharing (beside the strategic employee sharing[44]) as a new form of employment. Its main aim is to cushion the negative social effects of restructuring. However, it should be highlighted that the Eurofound's study has found that employee sharing between the employers that are affiliated by ownership, as in the case of Croatian temporary outplacement to affiliated company or, similarly, in the Hungarian model of employee sharing represent an older type of employment that has not become increasingly common. Therefore, this model was explicitly excluded from the analysis of *ad hoc* employee sharing.[45]
Nevertheless, the temporary outplacement to an affiliated company could have numerous advantages as an instrument of flexicurity. It can be used as an alternative to dismissals or reduction of working time; an instrument to prevent partial unemployment what is especially important in times of crisis; in the case of restructuring in the same group of companies or in case of redundancies as part of the social (or retention) plan. On the other hand, there are disadvantages too. First, similarly to temporary agency work, it is a complex three-sided relationship and as such creates legal uncertainty and insecurity, especially for the worker. Furthermore, the provisions of Croatian LA on temporary outplacement are unclear and fragmentary, leading in turn to legal uncertainty.
The most critical issues of the temporary outplacement in Croatian legislation are the length of the period of assignment (outplacement), possibility to change the employment terms and conditions during the outplacement and rights, duties and responsibilities of the employer and affiliated employer.
The LA limits the temporary outplacement to six consecutive months. There are no other limitations, e.g. the number of outplacements per year or the period between each outplacement. Therefore, it seems that Croatian employers can easily assign workers almost uninterruptedly, with their consent, using a very short period between each outplacement (e.g. two days).[46]
The second issue concerns employment terms and conditions of the outplaced worker. From the LA provision on data that should be included in an agreement between the employer and affiliated employer (company) concerning the place of work, worker's tasks, wage and bonuses and working day (week), it is not clear whether the working conditions stipulated in the employment contract may be changed (and if yes, how) because of outplacement. Therefore, different interpretations are possible. According to one opinion, the worker should be guaranteed the same or better job and wage. The inevitable modification of the employment terms and conditions in case of outplacement itself is detrimental to the

[43] Novaković, N. (2016), Novi modeli fleksibilnih oblika zapošljavanja, *Radno pravo*, no. 6, p. 4; Grgurev, I., Vukorepa, I. (2017), Flexible and New Forms of Employment in Croatia and their Pension Entitlement Aspects, in: Transnational, European, and National Labour Relations (ed. G. G. Sander et al.), Springer Verlag, Heidelberg … [etc.] (forthcoming)
[44] This form of employment would be interesting for Croatian employers who employ seasonal workers.
[45] Eurofound (2015), New forms of employment, pp. 7, 22; available at: https://www.eurofound.europa.eu/sites/default/files/ef_publication/field_ef_document/ef1461en.pdf, 30.5.2016.
[46] Rožman, K. (2014), Članak 10, in: Detaljni komentar novoga Zakona o radu (ed. K. Rožman), Rosip, Zagreb, p. 55.

contractual relation. However, it is just an exception that is in line with the purpose of the institution of temporary outplacement, namely to guarantee the efficiency of business activities of affiliated companies, as a temporary solution when the employer does not need a worker. Therefore, the other employment terms and conditions should not be modified. At the same time, there is reason for concern about possible, though unacceptable broad interpretation, according to which the wage and other working conditions during the period of outplacement may be worse comparing to those stipulated in employment contract because the worker has given his consent.[47] Such interpretation could easily become a common practice.[48] Consequently, the misuses of the institute are likely to happen in practice. However, in my opinion, until we have unclear rules, the broad interpretation regarding the modification of the working conditions to the worse is acceptable because security of employment must be a priority. Most likely, the courts will have to draw a line between misuse and necessary modifications.

Furthermore, the status of temporary outplaced worker becomes more complex due to the unclear provisions about the rights and duties of employer and affiliated employer. The majority opinion is that, as a rule, the wage is paid by the (initial) employer,[49] but it is not excluded that based on the agreement between the employer and the affiliated employer that duty can be imposed on the latter. It is doubtful whether the outplaced worker may claim termination of his/her consent if the affiliated employer does not fulfil his duties. The question to be answered is what is the nature of the worker's consent that becomes integral part of the employment contract? The problem also arises concerning the procedure of dismissal with or without notice in connection with the employee's conduct. Moreover, there are no specific rules regulating compensation for damage caused to the worker or to the affiliated employer by the worker. The affiliated employer has the duty to make the worker familiar with the necessary professional competencies and skills, as well as with the risks concerning safety and health at work protection and to train him for safe work.

In short, it may be concluded that an urgent modification is needed to the praiseworthy institution and which may be not only a guarantee of security of employment, but also a tool in restructuring procedure.

5. EMPLOYMENT PROMOTION MEASURES OF THE CROATIAN EMPLOYMENT SERVICE

Croatian Employment Service (CES) could play an important role in the process of restructuring. In case of projected collective redundancies, according to the Art. 127 LA, the employer should notify CES of consultations with the works council on possible redundancies. The notification must contain information about relevant data,[50] about the duration of consultations with the works council, outcomes and conclusions resulting therefrom, with a written statement of the works council, if such a statement has been delivered. The works council can provide CES with comments and suggestions in connection with the made consultations. Within a period of 30 days from the notification, CES may request the employer to postpone dismissals of all or some of the redundant workers for the next 30 days. The prerequisite for this is that CES can ensure the continuation of employment

[47] Milković, D. (2015), p. 139.
[48] Rožman, K. (2014), p. 56.
[49] Potočnjak, Ž. (2014), Najznačajnije novine koje donosi novi Zakon o radu, *Hrvatska pravna revija*, 9, p. 17, Milković (2015), p. 139, Rožman, K. (2014), p. 56ff.
[50] The reasons for the projected redundancies, the number of workers normally employed, the number and categories of workers to be made redundant, the criteria proposed for the selection of the workers to be made redundant, the amount and method for calculating any redundancy payments and other pays to the workers, and the measures designed to alleviate the consequences of redundancy for workers.

for workers during this extended period. To that purpose, CES has different measures at its disposal. Some of the active employment policy measures (AEPM) carried out by CES serve as an alternative to dismissal. This part analyses measures directed to employers in difficulties trying to preserve jobs. In 2016, there were only 82 beneficiaries of subsidy for preserving employment. Compared to other AEPM measures, this one had the smallest number of beneficiaries.

It must be emphasised that at the beginning of this year a new package of measures was adopted that reduced the number of measures, albeit to the purpose to achieve more clarity and availability. The measures are coordinated with the Ministry of Labour and Pension System.[51]

Job preservation measures are subsidies that aim to preserve the jobs under employers facing temporary decrease of the business activities and/or loss in business. Two measures for preserving jobs are subsidy for the reduction of working time and subsidy for worker's education. In both cases the employer should make an appropriate programme for job preservation. The programme must include data on past, present and planned measures for preserving jobs (e.g. revision of the business costs, wage reductions, reduction of wage, abolition of the remuneration for the members of the governing body and other measures), as well as data on expected number of preserved positions.

The novelty is that the measures can also use workers older than 50 employed by the employer facing difficulties or who cannot fulfil their working duties in full due to personal working or other characteristics. The maximum period for awarding the subsidy is six months for each worker. In case of reduction of working time, the subsidy is proportionate to the amount of wage for the number of working hours that were reduced (up to 40 % of reduction of working time and up to 40 % of the gross salary) up to the amount of the minimum wage, according to a special regulation.[52] The amount of the subsidy for the worker's education covers the total cost of education (that should be realized in the institution specialized for the education of adults). In case of reduction of working time and education of the worker employed with the employer who undergoes restructuring, the employer should present a restructuring plan adopted by the employer's governing body. The works council, resp. trade union and employer should sign an agreement on the acceptance of the programme on job preservation. If works council is not organized or trade union does not operate, the employer should inform the workers of the mentioned programme.

The permanent seasonal worker subsidy aims to support those workers who work only during the season. The measure can be used by employers in all branches of activities that due to the seasonal nature of activity have a period of decreased business activity. The condition that needs to be met is a continuous six-month employment by the same employer and the continuation of the employment for at least one (before: three) season. The duration of the subsidy is six months. The amount of the subsidy for employer is a 100% payment for the so-called prolonged pension insurance contribution for the first three months, and 50% for the next three months. The worker receives financial compensation up to six months and up to 70 % of the average wage paid in Croatia in the real sector for the first 90 days, and up to 35 % for the rest period. The employer can use this measure for a number of permanent seasonal workers that is equal to the number of workers employed on indefinite time.

CES also finances subsidies for the improvement of employability, useful especially for young new-employed workers and older workers who are at risk of job loss due to the modification of production process, introduction of new technologies or higher standards.

[51] Croatian Employment Service, Mjere aktivne politike zapošljavanja, available at: http://mjere.hr/, 29.5.2017
[52] Act on Minimum Wage (*Zakon o minimalnoj plaći*), OG no 39/13.

For the employers in difficulties or in a process of restructuring CES offers help through its mobile teams, established by the regional offices. The aim was to prepare the workers who are at risk of dismissal for the labour market and mediate for them while they are still employed, in order to prevent or reduce their entry into the register of unemployed persons. The team offers information for groups and individuals, individual consultation and help in assessing the working potential of the worker, help in recognizing the transferable and other skills necessary for employment in new positions, preparation of job search plan and psychosocial support.

6. CONCLUSION

The development of different strategies and policies, as well as the implementation of different institutions and measures represent important means to prevent and mitigate the negative impacts of company restructuring on workers and the wider community. Today, socially responsible restructuring means an anticipated planned and carefully managed restructuring.

This contribution has analysed some of the institutions and measures implemented in the process of restructuring in Croatia. Temporary outplacement of the worker to an affiliated company (employer) is a novelty introduced by new Labour Act in 2014. This form of atypical employment could significantly mitigate the negative effects caused by the fact that an employer temporarily cannot provide work for his workers. However, the rather unclear regulation demands modification *de lege ferenda* in order to achieve legal certainty and prevent possible misuses. The subsidies for job preservation and subsidies for improvement of employability as measures offered by the Croatian Employment Service and Ministry of Labour and Pension System, can be useful as individual measures in restructuring and improvement of workers competitiveness in the labour market. However, the best results can be achieved only by a strategic development of one or more models of restructuring as enforced by different EU Member States. The necessity to take a new direction is emphasised in the recent European Parliament's Resolution (2016), referring to two cases of large-scale restructuring. At the same time we have witnessed cases of large-scale restructuring in Croatia, unfortunately, without a timely response. A recent case in point Agrokor urges us to rethink company restructuring in Croatia.

ACKNOWLEDGEMENT: *This paper has been fully supported by the Croatian Science Foundation – Project UIP-2014-09-9377 "Flexicurity and New Forms of Employment (Challenges regarding Modernization of Croatian Labour Law)".*

LITERATURE:

1. Bejaković, P., Gotovac, V. (2011), Aktivnosti na gospodarskom oporavku u Republici Hrvatskoj s naglaskom na tržište rada, *Revija za socijalnu politiku*, vol. 18, no. 3, pp. 331-355.
2. Bilić, A. (2011), Fleksibilnost i deregulacija u radnim odnosima (PhD thesis), Pravni fakultet, Split.
3. CEDEFOP (2010), Socially responsible restructuring (Effective strategies for supporting redundant workers), Publications Office of the European Union, Luxembourg.
4. Croatian Employment Service, Yearbook 2015, 2016.
5. Deakin, S., Morris, G.S. (2012), Labour Law, 6th ed., Hart Publishing, Oxford.
6. Eurofound (2015), New forms of employment, available at: https://www.eurofound.europa.eu/sites/default/files/ef_publication/field_ef_document/ef1461en.pdf, 30.5.2016

7. Eurofound and EU-OSHA (2014), Psychosocial risks in Europe: Prevalence and strategies for prevention, Publications Office of the European Union, Luxembourg.
8. Grgurev, I. (2013), Labour Law in Croatia, Kluwer Law International, Alphen aan den Rijn Grgurev, I., Vukorepa, I. (2015), Uloga sindikata u doba gospodarske krize u Hrvatskoj, *Zbornik Pravnog fakulteta u Zagrebu*, vol. 65, no. 3-4, pp. 387-408.
9. Grgurev, I., Vukorepa, I. (2017), Flexible and New Forms of Employment in Croatia and their Pension Entitlement Aspects, in: Transnational, European, and National Labour Relations (ed. Sander, G. G. et al.), Springer Verlag, Heidelberg … [etc.] (forthcoming)
10. Hiessl, C., Laleta, S. (2017), Implementation problems of the Collective Redundancies Directive and their consequences: the Croatian example, *Europäische Zeitschrift für Arbeitsrecht* (forthcoming).
11. Labour Act, Official Gazzette (OG), no 93/2014.
12. Laleta, Sandra (2017), Individual Dismissal in Croatia, in: Transnational, European, and National Labour Relations (ed. G. Sander et al.), Springer Verlag, Heidelberg … [etc.], (forthcoming)
13. Milković, D. (2015), Sporna pitanja novog Zakona o radu, in: Aktualnosti hrvatskog zakonodavstva i pravne prakse, 22, Organizator, Zagreb, pp. 131-172
14. Milković, D. (2014a), Članak 115, in: Detaljni komentar novoga Zakona o radu (ed. K. Rožman), Rosip, Zagreb, pp. 409-424.
15. Milković, D. (2014b), Novi Zakon o radu, in: Aktualnosti hrvatskog zakonodavstva i pravne prakse, 21, Organizator, Zagreb, p. 141-195.
16. Novaković, N. (2016), Novi modeli fleksibilnih oblika zapošljavanja, *Radno pravo*, no. 6, pp. 3-8.
17. Potočnjak, Ž. (2014), Najznačajnije novine koje donosi novi Zakon o radu, *Hrvatska pravna revija*, 9, pp. 14-30.
18. Potočnjak, Ž. (2016), Neki problemi primjene Direktive o kolektivnom otkazivanju ugovora o radu u hrvatskom zakonodavstvu i praksi, in: Aktualnosti hrvatskog zakonodavstva i pravne prakse, 23, Organizator, Zagreb, pp. 229-277.
19. Potočnjak, Ž. (2015), Novine i dvojbe u svezi s otkazom i drugim načinima prestanka ugovora o radu, in: Zbornik 53. susreta pravnika Opatija, Hrvatski savez udruga pravnika u gospodarstvu, Zagreb, pp. 103-135.
20. Potočnjak, Ž. (2007), Prestanak ugovora o radu, in: Radni odnosi u Republici Hrvatskoj (ed. Ž. Potočnjak), Zagreb, Pravni fakultet u Zagrebu, Organizator, Zagreb, pp. 375-494.
21. Rogovsky, N. et al. (2005), Restructuring for corporate success: A socially sensitive approach, International Labour Office, Geneva.
22. Rogovsky, N., Socially Sensitive Enterprise Restructuring (ILO/SSER) ILO, Geneva, available at: http://www.abird.info/webcontent/images/stories/materiali/seminar_20_05_2010/SSER.Bulgaria.pdf, 27.5.2017.
23. Rožman, K. (2014), Članak 10, in: Detaljni komentar novoga Zakona o radu, Rosip, Zagreb, pp. 45-64.
24. Salais, R. (2014), Labour, Capabilities and Situated Democracy, in: Destructing Flexicurity and Developing Alternative Approaches (ed. M. Keune and A. Serrano), Routledge, New York, London, pp. 116-134.
25. Senčur-Peček, D., Laleta, S., Kraljić, S. (2017), Labour law implications of outsourcing in public sector, *Lex localis* (forthcoming).
26. Smokvina, V. (2017), Collective Dismissal in Croatia, in: Collective Dismissal in the European Union: A Comparative Analysis (ed. R. Cosio et al.), Kluwer, Alphen aan den Rijn, pp. 35-49.

27. Sočković, K., Crgić, I. (2015), Zaposlenost mora biti prioritetni nacionalni cilj, *Privredni vjesnik*, no. 3901, 9.11.2015.
28. Standing, G. (2011), The Precariat: The New Dangerous Class, Bloomsbury Academic, London, 2011
29. Supiot, A. (2005), Beyond Employment (Changes in Work and the Future of Labour Law in Europe), Oxford University Press, New York.
30. Zimmermann, B. (2014), From Flexicurity to Capabilities, in: Destructing Flexicurity and Developing Alternative Approaches (ed. M. Keune and A. Serrano), Routledge, New York, London, pp. 135-151.

IMPACT OF SUBSEQUENT TERMINATION OF BROKERED SALE AND PURCHASE CONTRACT ON THE BROKER`S RIGHT TO A COMMISSION

Senija Ledic
County Court of Split, Croatia
sledic@yahoo.com

ABSTRACT

Positively confronted interests of the vendor of real property to sell and the purchaser to purchase frequently require brokerage of a third party, whose role is to establish a relationship between aforesaid two parties. This is, in fact, the basis of the real property market; to satisfy, on the one hand, the vendor`s need to make a successful and fast sale of the real property and, on the other hand, the purchaser`s aim to make a purchase under most favourable conditions. For the purpose of creating balance between vendors and purchasers, the brokerage contract imposes upon the broker, as the main obligation, to achieve a mutual conclusion of the contract between the vendor and the purchaser, i.e. the principal and the third party. However, the broker does not exercise the right, i.e. request to realise the principal`s obligation of paying the commission at the moment when he creates the link between the principal and the third party, not even when the vendor and the purchaser negotiate the conclusion of the contract, but only when the vendor and the purchaser conclude the brokered contract. The paper analyses the issues of impact of subsequent termination of brokered sale and purchase contract on the broker`s right to a commission. It provides answer to the following questions: if non-compliance of the brokered contract affects the broker`s right to a commission, with special emphasis on the termination of the contract and voluntary withdrawal from the contract; which party from the brokerage contract assumes the risk of non-compliance of the brokered contract; if the parties to the brokerage contract are authorised to stipulate that any non-compliance of the brokerage contract indeed affects the broker`s right to a commission; and how does nullity of the contract between the principal and the third party affect the broker`s right to a commission if the broker had or had not been aware of the nullity reasons.

Keywords: *broker, brokerage contract, principal, right to a commission*

1. INTRODUCTION

Real Estate Brokerage Act is the basic source of legal regulation in civil obligations law regarding brokerage in real estate transactions in the Republic of Croatia since 2007. Subsidiary sources include brokered contract rules prescribed by the Real Estate Brokerage Act (Articles 835 and 848) and general rules on contractual relations implemented in the application of the Real Estate Brokerage Act, unless said Act prescribes otherwise (Article 15 para. 4 of the Real Estate Brokerage Act). Provisions of the Real Estate Brokerage Act, in the part on cross-border provision of services, are harmonised with *acquis communautaire* of the EU, i.e. with Directive 2006/123/EC on internal market services based on which real estate brokerage can be performed, with a fee, only by brokers who meet the criteria pursuant to this Act, if their registered office is on the territory of the Republic of Croatia, and by the brokers from the signatory countries of the European Economic Are,a who meet the requirements in conformity with the regulations of the state of their establishment. Real Estate Brokerage Act regulates the real estate brokerage activity as a specialised service-providing activity, whereas the mere notion of a brokerage contract in Croatian law is not limited to contracts or entities of civil or commercial law, but rather includes them both and is adapted to them (Gorenc et al., 2014).

2. LEGAL NATURE OF A BROKERED REAL ESTATE CONTRACT

Brokered real estate contract is a consensual legal transaction and as such occurs by the very agreement of the contractual parties. It is also a legal transaction of pecuniary interest because a counter-feasance is requested for a certain feasance (Article 15 para. 1 of the Real Estate Brokerage Act); it is considered formal because it is concluded in writing (Article 15 para. 2 of the Real Estate Brokerage Act). It is concluded for a 12-month fixed term, unless the parties stipulate otherwise, and it may be extended by an annex for as many times as the broker and the principal agree upon, i.e. for as long as the principal requires such contract or has a relevant interest (Article 15 para. 2 of the Real Estate Brokerage Act). That contract is concluded by adhesion, i.e. when a contracting party accepts previously stipulated business conditions of the other contracting party (Klarić, Vedriš, 2014). Provisions of the Real Estate Brokerage Act are predominantly (semi)strict in terms of the brokered contract, which means that the provisions of the Act cannot be excluded, i.e. limited by the contract, unless a certain provision expressly allows different agreement of contractual parties or different agreement on the principal`s overt interest (Article 15 para. 6 of the Real Estate Brokerage Act). The broker is obligated by the brokered real estate contract, in conformity with the Real Estate Brokerage Act (Article 15 para. 1 of the Real Estate Brokerage Act), and by the brokered contract pursuant to the Civil Obligations Act (Article 835), to introduce the principal with the person who would negotiate the stipulation of the contract with him, and the principal is obligated to pay a certain commission if the contract is concluded (Article 835 of the Civil Obligations Act). Hence, the Real Estate Brokerage Act and the Civil Obligations Act equally regulate the legal nature of the brokered contract, because in both cases the broker only undertakes to introduce third persons with the principal, and upon meeting such obligation, it is deemed that the broker has met his contractual obligation. In the legal doctrine of the Republic of Croatia, the issue arises as to whether a brokered contract, in general, can be concluded as commercial or consumer contract. Some authors (Baretić, online presentation) believe that said contract may be concluded either as a commercial or a consumer contract. Others, however, believe that the brokered real estate contract cannot be considered a consumer contract (Kulaš, Benedeković, 2015). According to the Consumer Protection Act, a consumer contract is a contract concluded between a consumer and a trader. A consumer is any natural person concluding a legal transaction or acting on a market outside of his commercial, business, trade or professional activity (Article 5 item 15 of the Consumer Protection Act). A trader is any person concluding a legal transaction or acting on a market within his commercial, business, trade or professional activity, including any person acting on behalf and for the trader (Article 5 item 26 of the Consumer Protection Act). A principal is any natural or legal person concluding a written brokered contract with a real estate broker (vendor, purchaser, lessee, lessor, landowner, tenant and other potential participants in real estate transactions – Article 2 item 7 of the Real Estate Brokerage Act). Considering the fact that a consumer can be any natural person, and a principal any natural or legal person, it can be concluded that the brokered real estate contract has some elements of a consumer contract if concluded by a natural person as the principal.

3. BROKER`S ACQUISITION OF THE RIGHT TO A COMMISSION

The broker`s right to a commission, which is the basic obligations of the principal towards the broker, does not have to be specially stipulated, because the Real Estate Brokerage Act (Article 28 para. 1) prescribes that a broker acquires the right to a commission only after concluding the brokered contract, unless the broker and the principal stipulate that the right to a commission is acquired by the conclusion of the pre-contract. On the other hand, the Civil Obligations Act prescribes that the broker is entitled to a commission even if it has not been stipulated (Article 844 para. 1).

In fact, if the parties have not stipulated the right to a commission, this shall not result in the nullity of the contract, since the obligation of commission payment occurs at the conclusion of the brokered contract, i.e. when the principal and the broker agree on the brokered contract. Consequently, the requirement for acquiring the broker`s right to a commission is the very conclusion of the brokered contract, whereby the conclusion of the brokered contract is also a suspensive condition for the occurrence of the broker`s right to a commission. Said condition is met at the very conclusion of the brokered contract, hence the broker acquires the right to a commission because it is then that the effects of the concluded contract enter into force. In that sense, the moment of acquisition of the right to a commission is also a moment when the broker`s request for its payment becomes due. In order for the broker to realise his right to a commission, the brokered contract should be concluded and the broker should meet his other obligations pursuant to Article 21 of the Real Estate Brokerage Act and Articles 835 and 840 paras. 1 and 2 of the Civil Obligations Act (i.e. to find a third person and introduce him to the principal and participate in negotiations if such obligation was assumed), since the acquisition of the right to a commission is related to the moment of the conclusion of the brokered contract.

3.1. Right to a commission in the event of a conditional contract

In general, the effects of the concluded contract enter into force upon its applicability and conclusion, even when the contract is concluded with a resolutory condition. However, the principal and the third person are entitled to stipulate a conditional contract, which means that the effects of the contract enter into force when a potential event occurs (suspensive condition) or they are terminated upon the occurrence of said event (resolutory condition). The contractual parties assume rights and obligations upon the stipulation of these conditions, which cease to exist once the resolutory condition has been met (Article 845 para. 3 of the Civil Obligations Act). In terms of the moment when these conditions enter into force, the contract stipulated with a resolutory condition may be equated with a contract stipulated without said condition, because in both cases the conclusion of the contract implies the assumption of rights and obligations, hence the fact that the principal and the third person concluded a contract with a resolutory condition does not affect the moment of occurrence of the broker`s right to a commission. Said right in fact occurs at the moment of conclusion of the contract. Since these parties assumed certain rights and obligations and since they are obligated to meet those obligations, even if they may be terminated by the very occurrence of the resolutory condition, the broker has, nevertheless, performed his task successfully, hence the subsequent occurrence of the resolutory contract does not impact the broker`s right to a commission, i.e. it continues to exist. In the event that the contract is concluded with a suspensive condition, its effect, i.e. rights and obligations of the other contracting party, has not entered into force yet, and it is uncertain if they would enter into force at all. By accepting the non-existence of the principal`s obligation to conclude a contract and other risks which may result in the loss of commission, the broker exposed himself to a serious possibility of losing the right to a commission in general, hence it is he who bears the risk of acquiring to right to a commission, even when his principal and the third person concluded a suspensive condition contract, i.e. conditioned their rights and obligations upon the occurrence of an uncertain future event. Therefore, if the principal and the third person concluded a suspensive condition contract, the broker acquires the right to a commission only upon the effectuation of said condition (Article 845 para. 2 of the Civil Obligations Act), because it is then when the effects of the conclusion of a valid contract between the principal and the third person enter into force (Slakoper, 2005).

3.2. Right to a commission in the event of contract nullity

Real Estate Brokerage Act does not contain the provisions on the right to a commission in the event of contract nullity, but that provision is contained in Article 845 para. 4 of the Civil Obligations Act, which prescribes that in the event of nullity of the contract concluded between the principal and the third person, the broker is entitled to a commission if he had not been aware of the cause of nullity. Here the notion of nullity extends to invalidity (Article 322 of the Civil Obligations Act) and voidability (Article 330 of the Civil Obligations Act). The broker is not obligated to participate in negotiations between the parties, hence it is possible that the contract concluded between the principal and the third party without his knowledge differs from the description of the contract contained in the brokerage order accepted by the broker. In such circumstances, despite the broker`s due diligence regarding his obligations, the contract between the principal and the third person may still be null due to any of the reasons of invalidity (contrary to the Constitution of the Republic of Croatia, coercive regulations or social morality) or voidability (limited work capacity, defects of will of the contractual parties at the conclusion of the contract, if the Civil Obligations Act or any other special regulation so prescribe). If the reasons of nullity are beyond the possible reach of a conscientious broker who entirely met his obligations from the brokered contract, the provision of Article 845 para. 4 of the Civil Obligations Act does not condition the broker`s right to a commission upon the validity of the contract, but on the broker`s due diligence. If the contract is null, the broker is entitled to a commission if he had not been aware of the cause of nullity, hence he acquired his right at the very conclusion of the null contract between the principal and the third person. *Argumentum a contrario* also applies here, i.e. if the broker had been aware of the cause of nullity, he is not entitled to a commission. (Gorenc et al., 2014).

4. IMPACT OF NON-COMPLIANCE WITH THE BROKERED REAL ESTATE CONTRACT ON THE BROKER`S RIGHT TO A COMMISSION

National legal regulation of the brokered real estate contract, as well as the brokered contract in civil obligations law, focusses on the broker`s obligation to find and introduce to the principal a person for the purposes of negotiating and concluding a legal transaction (contract) on the transfer or establishment of a certain real estate right (Article 17 para. 1 of the Real Estate Brokerage Act and Article 835 of the Civil Obligations Act). Hence, it can be said that the broker`s main obligation refers to a situation where one contractual party acquires a right in exchange for the other party`s counter-feasance, i.e. the broker`s obligation is to achieve the conclusion of the contract between the principal and the third person. However, the broker`s right to a commission paid by the principal is not acquired when he introduces the principal to a third person, or even when the principal and the third person negotiate a contract, but when the vendor and the purchaser conclude a brokered contract. Similar solution can be found in the German Civil Code (Bürgerliches Gesetzbuch) in the provision of Article 652 para. 1 which prescribes: “Whoever, for the purpose of acquiring the opportunity to conclude a contract or a brokered contract, promises a brokerage fee, he is obligated to pay said fee only when the contract has been concluded due the occurrence of said opportunity or broker`s brokerage” (*Wer für den Nachweis der Gelegenheit zum Abschluss eines Vertrags oder für die Vermittlung einen Mäklerlohn verspricht, ist zur Entrichtung des Lohnes nur verplichtet, wenn der Vertrag infolge des Nachweises oder infolge der Vermittlung des Mäklers zustande kommt*).

It derives from these provisions that the brokerage fee nominally originates when the contract has been executed and that the subsequent contract termination for any reason whatsoever does not have an adverse effect on the broker`s request for commission.

Munich Commentary of the German Civil Code (6th ed. 2012, para. 652, p. 158. (Münchener Kommentar zum BGB, 6. Auflage 2012, § 652 BGB Randnummer 158) states the following: "If the effect of the contract occurred, the subsequent non-effectiveness without *ex tunc* effect does not, nominally, adversely affect the broker`s request for the payment of the brokerage fee. The client bears the risk of effectuation of the main contract towards the broker. The broker`s request for the payment of the brokerage fee only depends on the occurrence of the main contract, and not its execution. This standpoint is contrary to the one stated in Article 87.a para. 1 of the S. Commercial Code where the request for the payment of commission of the commercial agent depends on the execution of the legal transaction: the agent bears the risk of conclusion and effectuation of the contract, whereas the purchaser bears the risk of its execution. It can be stipulated in the individual contract that the commission is independent of the effectuation of the main contract, but rather earned at the conclusion of the contract. On the other hand, the further existence of once valid main contract and the enforcement of the contract with its legal effect are irrelevant. As a result, the legal fate of the main contract and possible hindrances in its effectuation do not, nominally, adversely affect the broker`s commission request already occurred. On the contrary, the commission request does not occur when, based on a defect existing at the moment of the conclusion of the main contract, the contract has been null from the beginning or when its effect is subsequently removed."

Court practice in the Republic of Croatia essentially follows the legal standpoint that the subsequent termination of the brokered contract does not affect the broker`s right to a commission and that the principal bears the risk of effectuation of the contract in terms of the broker. For instance, the decision of the County Court in Split No. Gžo-235/14 of 5th March 2015 states the following: "It is legally irrelevant if the precontracts are subsequently terminated, as stated by the claimant, because the broker acquires the right to a commission at the moment of the conclusion of the brokered contract, unless otherwise stipulated."

However, the autonomy of the provisions on acquiring the right to a commission (Article 23 para 1 subpara. 5. of the Real Estate Brokerage Act and Article 845 para. 1 of the Civil Obligations Act) provides the parties with an opportunity to stipulate otherwise, e.g. to stipulate that the acquisition of the right to a commission occurs only upon the effectuation of the brokered contract, whereby the parties would transfer the risk of effectuation onto the broker, or to stipulate the conclusion without a brokerage fee, acquisition of the right to a commission regardless of the broker`s success and similar.

5. CONCLUSION

Besides the fact that the interests of the vendor of real property to sell and the purchaser to purchase are positively confronted, they also require mediation of a third person whose role is to establish a relationship between aforesaid two parties. This is what the real estate market is based upon, in order to, on the one hand, satisfy the vendor`s need for a successful and fast sale of real property and, on the other hand, to satisfy the purchaser`s desire to buy under the most favourable conditions. In the Republic of Croatia, real estate brokerage has been organised as a special service-providing activity regulated by a special law since 2007, in order to ensure a fair market game in real estate trade, which is managed by qualified brokers and offers optimum protection of vendors and purchasers. It also ensures that all stakeholders in real estate transactions comply with good business practices and that the state provides the mechanisms of real estate broker control with the aim to avoid the so-called grey economy. The brokered contract imposes upon a qualified broker, under aforementioned conditions, the main obligation of achieving a mutual conclusion of the contract between the vendor and the purchaser, i.e. the principal and the third person, so that order can be established on the real

estate market, as well as the balance between the vendor and the purchaser. It is only upon the conclusion of the brokered contract that the broker acquires the right to a commission, because the broker is entitled to a commission only if the sale and purchase contract has been concluded. Said right is acquired at the moment of the conclusion of the contract, because then the effects of a legal transaction enter into force. Bearing in mind that brokerage comprises factual work, and not undertaking of a legal transaction, the aim of brokerage is met when the broker has successfully performed said factual work, i.e. introduced a third person to the principal. The broker`s task is deemed successful when the parties conclude the sale and purchase contract, because at that moment the broker met his main brokerage obligation. As a result, subsequent termination of the brokered real estate contract or any hindrance in its effectuation do not, nominally, adversely affect the broker`s request for a commission payment, even though the parties may stipulate otherwise.

LITERATURE:

1. Directive 2006/123/EC on internal market services
2. Gorenc, V., Belanić, L., Momčinović, H., Perkušić, A., Pešutić, A., Slakoper, Z., Vukelić, M., Vukmir, B. (2014). *Komentar Zakona o obveznim odnosima*. Zagreb; Narodne novine.
3. Klarić, P., Vedriš, M. (2014.) *Građansko parvo*. Zagreb; Narodne novine.
4. Kulaš, M., Benedeković, M. (2015). *Zakon o posredovanju u prometu nekretnina u praksi*: https://www.hgk.hr/documents/predavanje-kulas58b545e0efbfc.p.
5. Münchener Kommentar zum BGB, 6. Auflage 2012, § 652 BGB Randnummer 158.
6. Slakoper, Z.,*Ugovor o posredovanju prema novom Zakonu o obveznim odnosima*, p. 58-59: www.agenti.hr/.../10-forum-Ugovor-o-posredovanju-prema-novom-Zakonu-o-obvez.
7. *Zakon o obveznim odnosima*, issue 35/05, 41/08, 125/11 and 78/14; Narodne novine.
8. *Zakon o posredovanju u prometu nekretnina*, issue 107/07, 144/12 and 14/14; Narodne novine.
9. *Zakon o zaštiti potrošača*, issue 41/14 and 110/15; Narodne novine.
10. County Court in Split, decision No. Gžo-235/14 of 5th March 2015.

PROTECTION OF PERSONAL DATA IN TURKISH LAW

Sevil Yildiz
Selcuk University, Turkey
syildiz@selcuk.edu.tr

ABSTRACT

The rapid development of information and communication technologies has caused personal data to be shared and spread more easily. Consequently; protection of personal data has become an important need. Personal data is defined as; any data about a real person whose identity is identified or can be identified. Within this context, not only the basic personal identification information such as the person's name, surname, date and place of birth, but any other personal data that can be directly or indirectly make such person identifiable, such as phone number, motor vehicle plate number, social security number, passport number, personal background, photo, video or audio records, fingerprints, genetics data, IP address, e-mail address, equipment identities, hobbies, preferences, contact persons, group memberships, family information etc. are included within the scope of personal data.

The right of the protection of personal data is included among the basic personal rights and freedoms. It is vital for the protection of the person's privacy and for the empowerment of democracy and the principle of the state of law. The basic reason for the protection of private life, including personal data, through constitutional guarantee is to allow for the free development of personality and to provide the person with a free environment where the person can be alone with himself/herself and his/her acquaintances without being disturbed by the state or by other people. Many legal arrangements have been made particularly on the international arena for the protection of personal data, which is one of the rights of personality. Among these, the Convention No. 108 for the Protection of Individuals with regard to Automatic Processing of Personal Data is the most significant one. This paper aims to analyze the Turkish law and legislation with regard to the protection of personal data. The current situation will be assessed with regard to conformance to international legislations.

Keywords: *Information technologies, Protection of personal data, Turkish Law*

1. INTRODUCTION

As information and communication technologies began to be part of our daily lives as they widespread, "information" began to gain value when compared with previous periods. Increased usage of "Information" in all kinds of economic and social activities of the community, made it necessary for these information to be transmitted in a fast and reliable way with reasonable costs and this change being lived through in economic and social ground began to be expressed with the concept of "information community" (Murray, 1998, p.112). Increase in the alternatives regarding the transmission, storage, alteration, classification, and searching of said information has brought up the question as how to protect the personal data defining and specifying an individual without giving any harm to the fundamental rights and freedoms.

Protection of personal data aims to protect the individual rights and freedoms during the processing of these data. In this frame, right to protect personal data aims not only to protect the data itself as being independent of the rights and freedoms of the individual but it also aims to protect the freedoms of the individual. Therefore, protection of individual data serves to protect the fundamental rights and freedoms of individual against unlimited collection, recording, usage, and transfer of personal data by the public bodies.

The adjustments made for this purpose, define the principles of having access to these personal data, using these data and processing them in general meaning and they provide various rights to the individual in cases where they are used by violating these principles (Kong, 2010, p. 443).

Threats developing against personal data which can be defined as all kinds of information suitable for specifying the identities of individuals, has made it necessary to develop a defence mechanism against the surveillance technologies and it was seen that it was required to have law for the protection of personal data. Adjustments aiming to inspect the person being related with personal data, has first come out in 1970s in Europe as the computers developed fast and central data banks were established and in time they spread around the world (Kaya, 2011, p. 331).

Even though our country, being a state of law that is democratic and respectful to human rights as being stated in 2nd article of Constitution dated 1982, is a member of organizations like United Nations, European Council and OECD, it could not transfer the principles accepted by international institutions in this area to its national law for a long time as there was no private law protecting personal data. By adding a sub clause to the 20th article of Constitution in 2010 for the regulation of private life which stated: *"Everyone has the right to request the protection of his personal data. This right also comprises notification of the person about his personal data, having access to these data, requesting them to be corrected or erased, and learning whether they are used in line with their purpose or not. Personal data can only be processed in situations where permitted by law or as per the explicit consent of the person. Basis and procedures as regards to the protection of personal data are regulated by law."*, protection of personal data of individuals was openly secured by the constitution. This regulation was criticized in that the conditions under which the protection of personal data could be restricted was not specified in the doctrine and that an independent organ to inspect the processing of personal data was not stipulated (Cengiz, 2016, p. 85).

"Contract for protecting the individuals against personal data's being made subject to automatic processing" with no.108 which was prepared within the body of European Council as being opened for signature on the 28th of January,1981 and being put in effect on the 1th of October,1985, was not approved for a long time although it was signed by our country on the 28th of January,1981 and finally as it was approved according to the law regarding 'Contract for protecting the individuals against personal data's being made subject to automatic processing" with no.6669, and it was put in effect on the 18th of February, 2016.

In the regulations of many states in Europe, laws regarding the protection of personal data are present for more than forty years (Kong, 2010, p. 442). Almost all of the modern states have introduced fundamental laws regarding this subject. It can be stated that for certain reasons there is an increasing pressure on the states not having made any adjustments regarding this subject, for the protection of personal data by the fundamental laws in national regulation. The first reason for this tendency is that importance was given for the protection of fundamental rights and freedoms in countries where there used to be authoritarian regimes before, in order to avoid experiencing similar cases. Another reason is the desire to eliminate the obstacles in front of commerce that develops through technology and mainly electronic trading. Third reason is realization of required amendments in the regulations of countries which would like to have trade with European countries as per the reason that the transfer of personal data to countries not providing sufficient protection of personal data has been prohibited according to European Union Directive with no 95/46/EC (Korkmaz, 2016, p. 221).

Although there are scattered provisions regarding the protection of personal data in our regulation, lack of a private law defining fundamental principles as being integrating, was seen as an important deficiency for a long time. All of the reasons stated above are present for having a fundamental law to protect the personal data in our country. Firstly, the outcomes of unjust interference to the individual rights and freedoms like unlawful tagging and security investigations at various periods in our country, reveal the damages that could occur in cases where personal data are not protected sufficiently. In case the required and sufficient measures are not taken, the probability for these kinds of unjust applications to occur in democratic managements always exists besides the authoritarian regimes. Having a private law in Turkey as regards to the protection of personal data is a requirement first of all as it is a fundamental human right. Furthermore, it is required to protect personal data in order to avoid our country to remain behind in economic activities like electronic trading that advances. Besides, as it is prohibited to make the transfer of personal data to countries which do not provide sufficient protection as per 25th and 26th articles of European Directive with no 95/46/EC, in order to enable effective trading to be realized with these countries and to avoid experiencing various problems due to the specified provisions, it is important to make an adjustment in our country in this direction. Furthermore, an adjustment to be made in this subject is also required as regards to the candidacy process of Turkey in European Union. The first committee to prepare a private law for protecting personal data in our country was established in 1989 but they could not complete their studies (Johnson, 2007, p. 46). Law draft prepared for the protection of personal data was sent to Presidency of the Grand National Assembly of Turkey on the date of 18.01.2016 by the Presidency. Committee of Justice has presented their report about the proposal on the date of 12.02.2016.The law for the Protection of Personal Data with no.6698 was finally accepted at the Grand National Assembly of Turkey of the 24th of March, 2016 and it became a law.

2. THE CONCEPT OF PERSONAL DATA THE PURPOSE OF LAW

The concept of personal data has been defined on the 3rd article of the law. Accordingly, all kinds of information relating to a real person whose identity is specified or could be specified, is being considered as personal data. A person's being specific or being specifiable has been defined in the justification as making that person definable by associating the existing data with the real person somehow. This definition complies with the definition of personal data made both in the European Council Agreement with no.108 and in the European Union Directive with no.95/46 (Cengiz, 2016, p. 88).

In the first article of the Law for the Protection of Personal Data with no.6698 with the heading of "Purpose", the purpose aimed to be attained by the law has been defined. Accordingly, the purpose of Law for the Protection of Personal Data is: "*To protect the fundamental rights and obligations of real and legal entities and mainly the confidentiality of private life while processing personal data and to regulate the liabilities of real and legal entities processing personal data and the rules and procedures which they shall comply with."*

In the justification of article, it was stated that with the article the purpose of Law was defined and that this purpose was to discipline the processing of personal data and to protect the fundamental rights and obligations stipulated in the Constitution, mainly being related with the confidentiality of private life. In the justification it was also stated that with the law it was aimed to protect the right of privacy of people which gained importance recently and to regulate the liabilities of real and legal entities and the rules and procedures they must comply with.

As the article text is reviewed, we can see that the purpose of law has been adjusted within the frame of 20th article of the Constitution. The article is in parallel with the 1th article of European Union Directive with no 95/46 (Korkmaz, 2016, p. 48).

2.1. Processing of Personal Data

Processing of personal data has been defined in the 3rd article of Law as: "All kinds of processes realized on the data like obtaining personal data through partially or completely automatic paths or through non automated paths on condition that they are part of a data recording system, their being recorded, stored, maintained, amended, readjusted, disclosed, transferred, taken over, being made attainable, being classified, or being avoided.". Therefore, all kinds of transactions realized on data starting from the point where personal data is attained for the first time, have been evaluated as processing of personal data. Apart from these, combining personal data, correlating them with other data, their being erased, and other processes realized for this purpose as covering a wide range of area, are also considered within the definition of processing of personal data (Kaya, 2011, p. 329).

In the 4th article of Law for the processing of personal data, the principles have been adopted. These are compliance with law and rules of honesty, being correct and updated as required, being processed for specific, clear, and legitimate purposes, being related, limited and restrained as per the purpose for which they are processed, and being stored for a period required for the purpose of their being processed and as being stipulated by the related legislation.

Processing of personal data has been linked with certain conditions. First of all, general rule for the transaction of processing is to obtain explicit consent of the related person. Or else, the processing of personal data has been prohibited. The concept of explicit consent has been defined in the law as consent that is based on being informed about a specific subject and which is expressed as per free will. In the articles 2/h and 7/a of the Directive with no.95/46, the consent of relevant person has been considered among the cases which legitimates the processing of data (Kılınç,2012, p. 1093).

As regards to the processing of data, there are certain cases when having the consent of data owner is not required. These cases are (Tekin,2014, p. 249):

- Having an explicit provision in law relating with the processing of data,

- Inability of relevant person to express his consent or its being required to protect the life and body integrity of relevant person, for whose consent no legal validity is attached, or some other person,

- The requirement for the processing of personal data of the parties on condition that they are directly related with the formation or realization of a contract,

- Its being required for the data responsible to execute his duties

- In cases where the data have been made overt by the relevant person

- Its being obligatory for a right to be established, used, or maintained,

- Its being required for the data to be processed as regards to the legitimate interests of data responsible on condition that no damage is given to the fundamental rights and freedoms of relevant person.

In the 6th article of the Law, data of people relating with their race, ethical origin, political view, philosophic beliefs, religion, sectarian, or other beliefs, dressing, membership in unions, foundations, or associations, health, sexual life, penal sentence, and security measures as well as their biometric and genetic data have been considered as personal data having private quality. In the 3rd sub clause of the article, personal data relating with health and sexual lives have been regulated privately in a different way than the others. Accordingly, all of the personal data other than those relating with health and sexual lives, could be processed in cases specified by the law without getting the explicit consent of the relevant person. But processing of these two types of data having private quality, could be possible if they are realized by people or authorized institutions having confidentiality obligation with the purpose to protect public health, preventive medicine, medical diagnosis, execution of treatment and care services, planning and management of health services and financing. Law requires for the measures being specified by the Council of Protecting the Personal Data to be taken in order for personal data with private quality to be processed (Ayözger, 2016, p. 188).

2.2. Transfer of Data

Transfer of data has been divided as domestic and foreign transfer as per the law. Transfer of personal data to other people within the country is subject to the rules stipulated for the processing of data. In this respect, for the realization of transfer process, first of all the consent of relevant person should be obtained. For realizing transfer to foreign countries, in addition to these conditions mentioned, it was stated that it is required for sufficient protection to be provided in the related foreign country (Küzeci, 2010, p. 76). Countries where there is sufficient protection will be determined and announced by the Council. In case the country to where data transfer will be realized does not provide sufficient level of protection, it is required for the data responsibly in both countries to undertake this protection as written and permit should be obtained from the council. As regards to the transfer of data to foreign countries, similar adjustments exist in the directive with no. 95/46. In the Directive, a system has been adopted which prohibits the transfer of data to third countries where there is not sufficient level of protection (Ayözger, 2016, p.188) .

2.3. The Tasks of Data Responsible

Data responsible has been defined in the 3rd article of Law as: " Real or legal entity specifying purposes and tools for the processing of personal data as being responsible for the establishment and management of data recording system.”This person is responsible from all kinds of processes realized as relating with the data. It is required for data responsible to enlighten the data owner about his identity and the identity of his representative,if any, about the purpose of processing data, about the people to whom the data will be transfered and the purpose of transfer, the method of collecting data, and its legal reason (Kılınç, 2012, p. 1096).

Acting in contradictory to the obligation to enlighten, to provide data security, and to realize the decisions taken by the council, as including the liability to unregister and to make notification, has been adopted as being a crime according to the law.

As within the scope of obligation to enlighten, data owner has the right to learn whether any processing has been done on his data or not, to obtain information about the purpose and method in case such processing is done, to be notified about third parties to whom his personal data has been transferred within or outside the country, to ask for the correction of any possible deficiencies or mistakes as relating with processing of personal data, to make objection to analysis outcomes of processed data being obtained through automatic systems, to request for the data to be erased or destroyed, and to ask to be indemnified due to the losses incurred as a result of unlawful acts (Tekin, 2014, p. 256).

Institution for the Protection of Personal Data, being responsible from the implementation of law, has been established. The decision making body of the institution being composed of council and presidency, is the Council of Protection of Personal Data. The tasks of the instution are to follow up the applications and legal developments in national and international ground, to make research and investigation regarding this subject, to cooperate with the relevant institutions and associations, and to make proposals as regards to the subject matters required (Kaya, 2011, s. 329).

3. CONCLUSION

All kinds of information belonging to a person which makes a person defined or definable are considered as personal data. Protection of these data is a fundamental human right. Obtaining and processing of personal data in an uncontrolled way, is threatening many fundamental rights and freedoms, and mainly the confidentiality of private life. In our country with the addition of provision with no.20/2 to the Constitution in year 2010, the required legal basis for the protection of personal data has been established. Thus, individuals began to be protected at Constitutional level. But it has taken a long time to complete this regulation, being important as regards to the data protection law, with a special law of implementation as relating with the subject. Turkey has remained as the only country which has signed the Contract of European Council with no.108 but which could not approve it since a private law being specified as obligatory in the contract could not be introduced. This situation has given rise to a problem as European countries did not transfer personal data to countries where there was not sufficient protection. As a result of the studies carried out, the Law for the Protection of Personal Data was accepted on the 24th of March, 2016. As the law is investigated, it is seen that adjustments being parallel with Contract with no.108 and the Directive with no.95/46, have been made. Accordingly, it was adopted as the fundamental principle to process personal data according to the conditions specified in the law, to enlighten the data owners, to establish an authority for inspecting and regulating this area, and to take the necessary measures as relating with data security. Furthermore, with the Law that was prepared by considering current and future requirements, it was aimed to catch up with the contemporary standards and to provide protection in this direction. In order to minimize the problems that could arise as relating with this subject, it is especially important to inform the individuals and relevant institutions about data security and to improve their consciousness.

LITERATURE:

1. Ayozger,C. (2016). *Kişisel Verilerin Korunması*. Turkey: Beta
2. Boz, A. (2014). *Kişisel Verilerin Korunması: Türkiye, ABD ve AB Örnekleri* (Master's thesis), Polis Akademisi Güvenlik Bilimleri Akademisi.
3. Cengiz,T. (2016). Uluslararası Düzenlemelerde ve Türkiye'de Kişisel Verilerin Korunması. In Selda Güneş Peschke, Lutz Peschke. *New Media and Law: A Comparative Study.* Ankara: Yetkin
4. Johnson,E.H. (2007). Data Protection Law in the European Union, *The Federal Lawyer*. USA
5. Kaya, C. (2011). Avrupa Birliği Veri Koruma Direktifi Ekseninde Hassas (Kişisel) Veriler ve İşlenmesi. *İÜHFM*. 69 (1-2). İstanbul
6. Kılınç,D. (2012). Anayasal Bir Hak Olarak Kişisel Verilerin Korunması. *AÜHFD*. 61(3). Ankara: Adalet.
7. Kong, L. (2010). Data Protection and Transborder Data Flow in the European and Global Context. *European Journal of International Law*. 21(2).

8. Korkmaz, I. (2016). Kişisel Verilerin Korunması Kanunu Hakkında Bir Değerlendirme. *TBB Dergisi*. 124. Ankara: Adalet.
9. Küzeci,E. (2010). *Kişisel Verilerin Korunması*. Ankara: Turhan
10. Murray, J.P. (1998). The Adequacy Standart Under Directive 95/46/EC: Does U.S. Data Protection Meet This Standart?. Fordham International Law Journal, 21 (932).
11. Tekin, N. (2014). Kişisel Verilerin Korunması İle İlgili Türkiye'deki Kanun Tasarısının Avrupa Birliği Veri Koruma DirektifiIşığında Değerlendirilmesi . *Uyuşmazlık Mahkemesi Dergisi*. 78(1). Ankara.

A COMPARATIVE STUDY OF HUMAN RIGHTS EDUCATION IN MAINLAND CHINA AND TAIWAN REGION

Shen Taixia
Law School of Jinan University, China
sunbird726@hotmail.com

ABSTRACT

This paper studies the history, current situation, the problems of human rights in mainland China and Taiwan region by a comparative method. It argues that human rights education has had its own characteristics during its development in mainland China and Taiwan region, and intends to identify its common problems then give some suggestions in order to achieve sustainable development. First, this paper surveys the histories of human rights education in mainland China and Taiwan region. Second, it summarizes the characteristics of human rights education in these two regions objectively, then identifies some common challenges for promoting human rights education and gives some ideas and suggestions for its future sustainable development. Both of human rights education in Mainland China and Taiwan region has seen great improvement, it also has its own characteristics during its development. Although human rights education met different challenges in the these two different areas in Greater China, there are some common problems. Ensuring and promoting the respect of human rights in society is the main goal of human rights education. Balanced development, independent development, the encouragement of and investment by the government , enterprises and society in the subject and the high quantity and quality of available human rights teachers are the guarantees for a sustainable model of human rights education in both of mainland China and Taiwan region.

Keywords: *Human rights education, Mainland China, Sustainable development, Taiwan region*

1. INTRODUCTION

There has been a lack of human rights education for a long period since the People's Republic of China was founded. Human rights courses were opened in some colleges and universities in the 1990s in mainland China. With the development of democracy and social progress in mainland China, human rights education developed quickly between 2001 and 2011 (Fang and Zhang, 2012,pp. 40-44). In 2004, the term "human rights protection" was written into the Constitution of the People's Republic of China. Human rights education has gained recognition from the government and civil society on the mainland. Human rights research and training centers have been established gradually all over the country, and many colleges and universities in mainland China have established human rights courses to teach students human rights law. It is very interesting that human rights education of Taiwan region has been promoted since the 1990s. After the first term of exchange of parties in 2000 , the human rights education has great progress, the new government point out it would establish Taiwan by human rights, and this idea was reflected in its legislation, diplomacy and education. For promoting human rights education, the Ministry of Education of Taiwan set up Human Rights Education Comission and adpot the Implementation Program of Human Rights Education in 2001. Human rights education in mainland China and Taiwan region has its own characteristics during its development while these two regions meet some common challenges for promoting human rights education. First, this paper introduces the historical development of human rights education in mainland China and in Taiwan region. Second, it analyzes the characteristics of human rights education in these two regions.

Third, it analyzes some common challenges of human rights education in these two regions and finally this paper argues that both of human rights education in mainland China and in Taiwan region should address the existing problems for its sustainable development. Based on the analyzes of each part of the study, it makes a conclusion.

2. HISTORIES OF HUMAN RIGHTS EDUCATION IN MAINLAND CHINA AND TAIWAN REGION

2.1. History of human rights education in mainland China

At the foundation of the People's Republic of China, the government made no mention of the term "human rights". During the Cultural Revolution, a number of heinous massacres took place, and human rights and the rule of law were distorted throughout that period. The leaders of the Communist Party of China reflected after that Cultural Revolution, and recognized the significance of the rule of law and the protection of human rights. Research on human rights appeared in the 1980s, when human rights education was introduced at the university level and it was often included in international law courses, as part of constitutional law or the theory of law. There were no specific human rights courses in schools, however. In the 1990s, some law schools opened human rights courses for undergraduate and postgraduate students at universities. In 1993, the Vienna Conference on Human Rights appealed to countries to promote the development of human rights education effectively. In 1995, the 49th United Nations General Assembly adopted a resolution, which fixed a ten-year period from 1995 to 2004 for the promotion of human rights education in order to advance its popularization around the world. At that time, human rights courses in mainland China were not standalone programs. Instead human rights education was included as part of moral, political and legal courses at the primary, secondary and tertiary levels. The springtime of human rights education in mainland China came after the fourth amendment to the Constitution of the People's Republic of China in 2004. The term "the state respects and protects human rights" was clearly written into the Constitution, which opened a new era of human rights development. In this new situation and circumstance, the popularization by the state of human rights education was undoubtedly a crucial part for the development of human rights. Thus, human rights courses and research centers were set up by many colleges and universities. Several national conferences on human rights education and research were held for exchanging information and experiences. In 2009, the first National Human Rights Action Plan (2009- 2010) was issued by the government, then the second was issued (2012-2015) in 2012. Promoting human rights education has been the goal of these two plans, specifically, carrying out human rights training and various forms of human rights education at all levels, the requirements of which are improving human rights awareness in society. The Ministry of Education of the People's Republic of China (MOEPRC) and the State Council Information Office of the People's Republic of China (SCIOPRC) have chosen several academic organizations and institutions as national human rights education and training bases. As at 2014, there were eight national human rights education and training bases in mainland China. These favored institutions obtained significant funding and support from the MOEPRC and the SCIOPRC. Intellectuals in mainland China have attached great importance to human rights education, believing it to be important for the development of human rights causes and the most effective means of promoting human rights in mainland China. In other words, they hoped to promote human rights by focusing on the education system. Human rights education has been considered to be a field which is supported better and treated less sensitively by the Chinese Government compared with other human rights causes.

They have argued that the government should be encouraged to plan, promote and facilitate human rights education, particularly human rights education at the university level, as the government has to take the initiative to establish human rights education, and set up human rights law courses in schools (Liu and Zhou, 2014,pp.215-219).

2.2. History of human rights education in Taiwan region

In Taiwan region, the beginning and development of human rights education was infulenced by the international and domestic environments. The human rights concept was discussed in the 1970s in Taiwan for human rights protection and democratic politics against the one-party autocracy. In the mid-1980s, many non-governmental organizations (NGOs) were established for advocating rights for the weaker sectors of Taiwan society with the gradual weakening of the regime. However, the promotion of human rights education in the formal education system started only in the 1990s. The beginning of human rights education was infulenced by the Education reform as the spirit of human rights education was supported by this education reform, yet teaching human rights was not made the core of the reform. Objectivily, human rights education greatly influenced by the United Nations Decade for Human Rights Education from from 1995 to 2004 with its focus on the notion of rights. The first attempt to promote human rights education in schools was in the autumn of 1995, when professor Huang Mab and his colleagues in the Department of Political Science at Soochow University started to offer human rights courses such as the *UN and international protection of human rights, human rights philosophy and ethics* at the undergraduate and graduate levels. Meanwhile, Professor Huang Mab, Professor Chou Pesu and Professor Huang Song-li of the Department of Public Sanitation of Yang Ming University, Professor Yu Bo-Chiun of the Academia Sinica, Professor Wu Yingchang of the Department of Psychology of National Taiwan University and Professors Tang Meiying, Dan Jauwei, Hsin Man-ling and Lin Pei-rong of the Taipei Municipal University of Education applied for funding to the National Science Council to develop teaching materials and training program for teachers. The proposed project had four components--pre-school, primary, junior and senior secondary, and tertiary levels--for a three-year period (Huang,2006, pp.73-81). In 1998, the Ministry of Education adopted a policy to include human rights topics in school curriculum through its *General Guidelines of Grade 1-9 Curriculum of Elementary and Junior High School Education*. However, the human rights were just as topics, the independent human rights courses did not exsit at that time. In 1999, human rights education has been confirmed by the Basic Law, this law recognizes the right to education, stipulates that the objective of education is to promote respect for basic human rights, and emphasizes the principle of equal access to education. From november 1997 to 1998, several workshops of human rights education were open for the teachers from primary schools and junior secondary schools, and several human rights education Camp were open for junior secondary school students; In 1998, a international conference on human rights was organized by the Soochow University, Yang Ming University and the Taipei Municipal University of Education. In 2000, the Chang Fo-Chuan Center for the Study of Human Rights at Soochow University was established, this centre made human rights education in tertiary education took a big step. This Center organized a number of international conferences on human rights, cooperated with some international or foreign insitutes to promote human rights education and research; it also invited a number of renowned foreign experts who contributed to the development of human rights education (Hawang, 2001). In the same year, after the first term of exchange of parties,the new government showed much interest in human rights through a number of initiatives. The government interact with the academia, NGOs of civil society to promote human rights education. Besides, the new government set up several organizations to develop human rights education. The Ministry of Education of Taiwan set up the Human Rights

Education Committee (Now is the Human rights Education Advisory and Resourses Center) for the Promotion of human rights education in 2001. During the first session of the Human Rights Education Committee, it adopted the *Implementation Plan for the Human Rights Education, Main Points for the Establishment of the Committee for Human Rights Education* and *Main Points of Subsidizing NGOs in Human Rights Education Activities*.(The Ministry of Education of Taiwan,2001,pp 31-34). The Human Rights Education Committee worked very well for promoting human rights education in the formation of four Sections, they are the Research, Development and Evaluation Section, Teacher Training and Curriculum Planning Section, Social Promotion and Publicity Section, and Campus Environment Section. Through many years, the Ministry of Education has been subsidizing the training of senior secondary schools principals and teachers, holding the workshop for the students from senior secondary schools. Furthermore, the Ministry of Education also funds NGOs. Every NGO is entitled to apply for subsidy in their human rights education activities, the maximum subsidy is 300 thousands NT$. Human rights education has been promoted grandually in the Junior-High and Elementary Schools, as well as at university and college, also at the Community University since the year of 2000s in Taiwan although some experts of human rights criticized that there was some retrogression of human rights education since the second term of exchange of parties in Taiwan. Till now, human rights edcuation diffused across Taiwan region. Finally, the contributions of NGOs to human rights education should be mentioned. They promote human rights education through launching the activities like Study Camps on Human Rights for the students, workshop on human rights for teachers or sudents. It is clear that the domestic and international environments and the improvement of human rights have influenced the development of human rights education in both of mainland China and Taiwan region, but the government's supportive policy is the main factor for its development. The different domestic environments and histories of development result in different characteristics of human rights education in mainland China and Taiwan region.

3. CHRACTERISTICS OF HUMAN RIGHTS EDUCATION IN MAINLAND CHINA AND TAIWAN REGION

3.1. Characteristics in mainland China

3.1.1 Universities and colleges take a very active part in human rights education

Unlike other countries and territories, human rights education in mainland China has been launched first at university and college, rather than at primary and secondary schools. Relying on their rich intellectual and academic resources, many top colleges and universities set up human rights courses quickly, mainly under the auspices of law teachers. Moreover, many universities and colleges established special human rights research institutions to promote human rights research and popularize human rights education. Research institutions and training bases play an irreplaceable role in the promotion of human rights education. First, these organizations carry out academic research and teaching work. Taking the Renmin University of China Human Rights Research Center as an example, by July 1, 2014 it had overseen about 63 master's theses and doctoral theses on human rights. Their research subjects related to both national and international human rights theory and practice. Human rights teachers at the Law School published many relevant articles and books and its professors organized research programs relating to human rights education. This center has disseminated human rights knowledge by offering human rights courses to undergraduate and postgraduate students. In addition, it has also received scholars from the USA, Australia, Sudan, Japan and Poland, etc., and it holds discussions with them on human rights problems (Chen, 2014, pp.35-39). Second, the research institutions and training bases have also organized international or domestic human rights academic forums and conferences, and communicated with international human rights organizations. The role played by China's

human rights research centers and training bases in cooperation and communication with foreign human rights research centers should not be overlooked. Human rights institutions in the Nordic region, such as the Raoul Wallenberg Institute for Human Rights and Humanitarian Law/RWI, the Norwegian Centre for Human Rights (NCHR) of the University of Oslo and the Danish Institute for Human Rights (DIHR) have supported China's human rights education development for many years (Bjornstol, 2009, pp.1-19).

Third, they can also provide expertise directly to China's legislature, executive and judiciary to advise on their compliance with relevant human rights laws and to solve practical human rights problems. Human rights education is consistently provided for civil servants. Many human rights research centers and training bases provide human rights legal training for government employees, especially for those working in the public security agencies, procuratorates, courts, prisons, urban management organs and administrative law enforcement bodies. For instance, from 2001 to 2003, the Rule of Law and Human Rights Research Center of Hunan University offered four terms of human rights law training for political and legal functionaries. From 2009, the Law School of Peking University launched human rights training for the leaders of Guangdong's provincial superior court (Liu, 2013, pp. 30-32). Thus, it can be seen easily that, though human rights education in mainland China was first studied by students at university and college, it has since been offered as part of professional training courses for civil servants. As yet, there have been no special human rights courses opened for students at primary and secondary schools, but some aspects of human rights education have been added as part of moral or political education in recent years. Since 2014, some universities have begun to give human rights lessons to teachers from primary and secondary schools.

3.1.2 Human rights courses as the main teaching arrangement for human rights education

How should human rights education proceed? In contemporary mainland China, giving human rights courses is the main method for disseminating human rights education. Human rights courses are given by the human rights research centers and training bases, or by law schools directly. There are already many human rights law courses or relevant courses at a variety of levels. Although the names of the courses vary between schools, in general they are known as "Human Rights Law," "Human Rights," "Introduction to Human Rights Law" or "International Human Rights Law." Many universities and colleges offer human rights courses with their own characteristics. Human rights courses are open to undergraduate and postgraduate students. They are open not just to law school students, but also to students from the other university faculties as general education courses. By 2012, human rights courses had been opened at more than 40 colleges and universities (Fang and Zhang, 2012, pp.40-44). In addition, many universities set up human rights research at law schools, especially for postgraduate students. In 2006, the China University of Political Science and Law added human rights law as a second degree subject(Ban, 2014, pp.31-34). Besides human rights courses and research direction at universities, law schools also launched human rights training programs for civil servants, opening human rights courses as a main means of professional training. It is true that some human rights research centers and training bases also offer legal aid services at a grassroots level, which works practically to bring an understanding of human rights knowledge to the broader society. Wuhan University Research Institute for Human Rights is a good example of this. In recent years, its legal aid practice has worked positively for its clients. The Public Interest and Development Law Institute of Wuhan University has also represented the rights of special groups and seen success via its grassroots legal work. Furthermore, the publication of human rights books and textbooks, and the creation of web sites by the human rights research centers and training bases have also

proved very important work. Human rights textbooks are some of the main resources of human rights education. There are many contemporary human rights textbooks in mainland China. Teachers use many materials about human rights, including some foreign books and jurisprudence works translated by Chinese scholars for human rights courses. There is no doubt that teachers of human rights play a very important role in human rights education at the university level in mainland China. Some of them have a good education and sturdy background knowledge. Some of them have studied overseas, which is the ideal basis for the internationalization of human rights teaching.

3.2. Characteristics in Taiwan region

Comparing with the development of human rights education in mainland China, the characteristics of development in Taiwan region can be sum up as follow.

3.2.1 Positive interaction between the academia, NGOs and government on human rights education

For promotion of human rights education in Taiwan, the government interact very well with the academia and NGOs. At beginning of human rights education, the academia and NGOs in civil society worked much for the delivery the concept of human rights. For instance, the Taiwan Association for Human Rights(TAHR) has committed to securing and protecting human rights from all forms of violation, has promoted human rights consciousness and education since its foundation in december 1984. It has held a series of seminars on human rights, the human rights summer or winter schools for the colleges students. Many professors of unviersities and colleges has launched human rights research and human rights courses, edited human rights textbooks, held human rights research and education conferences since 1990s. Luckily, the activities in the civil society for promotion of human rights education has been affirmed by the goverment, especially since 2000s, the Ministry of Education of Taiwan became as the main power for promotion of human rights education, and it also established the relative mechanisms. On the one hand, it has a sound financial base, on the other hand, it cooperates very well with the academia and the NGOs in civil society; It has great improvement for promoting human rights education. Human Rights Education Advisory and Resources Center of the Ministry of Education of Taiwan is a good example, it is the result of active government promotion and positive participation of academia and NGOs.

3.2.2 Pluralistic methods for human rights education

From the beginning of human rights education, the professors in Taiwan has encouraged pluralistic methods for carrying out human rights education, they has advocated the engage method, interaction with the teachers and students. For instance, professor Tang Meiying of the Taipei Municipal Teachers' College (now Taipei Municipal University of Education) promotes the idea that human rights education is a value-based activity that should allow the students to experience and explore the values of democracy, social justice and respect for human rights. Professor Tang Meiying proposes that human right knowledge, attitudes and practice are the three levels of human rights education, the ideas of human rights should be put into teaching activities. Teachers should adjust the teaching methods according to the ages and experiences of students. Teachers should lead the students to read the materials and take natural experiences to recognize and discuss the concept of human rights , lead students to understand the rights and responsibilities by stories, to find the violations of human rights from reading the stories,etc. (Tang ,2001). Even for the same grade levels of students, there are also pluralistic methods for teaching human rights.

Educators do not just give human rights courses, they hold the workshops, youth camps and other methods to implement human rights education. Besides, the are encouraged to develop curriculum of human rights by employing leaflets, comics, worksheets, storybooks and even video as teaching resources.

4. COMMON CHALLENGES TO HUMAN RIGHTS EDUCATION IN MAINLAND CHINA AND TAIWAN REGION

Though human rights education in mainland China and Taiwan region has achieved much, many different problems can be identified with its development. However, they meet several common challenges during the development of human rights education.

4.1. Unfavorable influence of traditional culture

There is little tradition of a human rights culture in Chinese history. Less than three decades ago, the Chinese government dismissed human rights as bourgeois and western concepts that were of little relevance to China (Oud, 2006, pp. 117-125). For a long time human rights were not valued by Chinese society. This cultural bias meant that special human rights courses were set up for developing human rights education in mainland China, but they had no aim to make human rights learning part of a lifelong process embedded in the everyday culture of the nation. In Taiwan, the education has been very conservative for many years. Some leaders in the bureaucracy misunderstand human rights education. Even in the workshop of human rights education, some headmasters and teachers opposite human rights education, some of them thought that they would not govern students if their students have human rights (Huang,2002,pp. 69-84). This reflects the conflict between the traditional culture and the culture of diversity, equality and tolerance. Both of mainland China and Taiwan region are the authoritarian societies for a long period, the traditional culture has unfavourable influence on human rights education.In consequence, educational aims directed at the full development of the human personality and at strengthening respect for human rights and fundamental freedoms will be difficult to achieve.

4.2. Finite resources for human rights education's development

Both of mainland China and Taiwan region meet the challenge of lack of resources for promoting human rights. In mainland China, the funds for human rights teaching are relatively low. Although the National Planning Office of Philosophy and Social Science (NPOPSS), the MOEPRC and the Ministry of Justice of the People's Republic of China (MOJPRC) have set up some funds for human rights research, they ignore the funds for human rights education. It is embarrassing that until the international funds for human rights are closely scrutinized, the unstable source of funding will inevitably restrict the sustainability of human rights education in mainland China. Social donations are also limited in this field. The MOEPRC allocates national funds to the national human rights education and training bases, but other NGOs providing human rights education cannot access these monies. Besides, there is a lack of qualified human rights teachers in some colleges and universities, and especially in primary and secondary schools. In some universities, the teachers of human rights courses are from criminal law, constitutional law or other related subject faculties, but there are no specialist human rights law teachers (Chen, 2010,pp.25-28). In Taiwan, though the Ministry of Education has provided financial support to some extent to human rights education, this support is not sufficient to satisfy the actual needs. The upgrading of facilities to promote human rights education within the schools, the establishment and continued operation of human rights education databank, the development

of new and more effective teacher training programs need be supported more than before. The financial support from entreprises and NGOS in civil soceity is not much. In addtion, both in mainland China and Taiwan region, most of the educational authorities at the county and township levels are indifferent to human rights education and thus not willing to be involved. There is unbanlanced development, human rights education developed quickly in developed areas while it was restricted in less developed areas. This paper has affirmed the achievements of human rights education in mainland China and in Taiwan region, analyzed the problems these two regions have experienced. Based on the research above, this paper argues that human rights education in mainland China and Taiwan region should be focused further on its sustainable development, and thus its sustainability should be enhanced during its further development.

5. CONCLUSION

Human rights education in mainland China and Taiwan region has developed since the 1990s, and it has developed very quickly in the past decade. The awareness of human rights encouraged by a more receptive international environment and the internal incremental improvements of democacy and the government supports are the main reasons for this rapid development. Human rights education in mainland China and in Taiwan region has had its own particular characteristics during this period. Human rights education in mainland has not developed well at primary and secondary schools, and it has not seeped far into the population's daily consciousness, though it has developed quickly at the university level. Meanwhile, Human rights education of Taiwan region has been promoted well at primary and secondary schools, even in the community. However, some common difficulties and obstacles still lie ahead. Having relied largely on government sponsorship, human rights education in mainland China and Taiwan has lacked intellectual independence, the funds for human rights teaching have been limited, qualified teachers have been lacking, the traditional culture has an unfavorable influence on its development. Enhancing the respect and protection of human rights in society is the main goal of human rights education. With this idea at the forefront, the internal impetus of development should be stimulated. The demands for human rights of society and the people themselves should become the main cause for the development of human rights education. With the popular dissemination of human rights, rule by law and democrary, both in mainland China and Taiwan region can overcome the weakness of traditional culture. Furthermore, the government and society should supply greater human, financial and physical resources for the sustainable development of human rights education in mainland China and Taiwan region.

ACKNOWLEDGEMENT: *This paper is the Periodical result of the research project of "the intellectual property in the perspective of human rights" (NO.13YJC820069), funded by the National Department of Education of the People's Republic of China.*

LITERATURE:

1. Ban, W.Z. (2014). Foreign exchange and cooperation in human rights education: a case study of the China university of political science and law. *Human Rights*, Vol. 13 No. 1, pp. 31-34.
2. Bjornstol, E.P. (2009). Human rights law education in China. *Web Journal of Current Legal Issues*, Vol. 13 No. 1, pp. 1-11, Retrieved 02.10.2014 from www.bailii.org/uk/other/journals/WebJCLI/2009/ issue1/pdf/bjornstol1.pdf.
3. Chen, H.N. (2014).Renmin university of China human rights research center. *Human Rights*, Vol. 13 No. 4, pp. 35-39.

4. Chen, Y.W. (2010). Problems in human rights education in China's universities and the solution (Gaoxiao Renquan Jiaoyu Cunzai de Wenti Jiqi Wanshan). *Journal of Guangzhou University- Social Science Edition (Guangzhoudaxue Xuebao-Shehuikexueban)*, Vol. 9 No. 1, pp. 25-28.
5. Fang, G.S. and Zhang, L. (2012). Popularization of human rights education of China within 10 years: from 2001 to 2011 (Zhongguo Renquan Jiaoyu Riyi Puji de Shinian 2001-2011). *Human rights (Renquan)*, No. 6, pp. 40-44.
6. Huang, Mab.(2002).The Present State and The Future of Human Rights Education in Taiwan. *National Policy Quarterly*, Vol. 1 No. 2, pp.69-84.
7. Huang, Mab.（2006）. Human Rights Education in Taiwan: Current Situation and Future Challenge. *Human Rights Education in Asian Schools*, Vol. 9, pp 73-81.
8. Hawang, Shiow Duan.(2001). A Center for the Study of Human Rights at Soochow University, a paper delivered at the International Conference on *National Human Rights Commissions: Promoting and Protecting Human Rights*, Taipei.
9. Liu, S.P. (2013). The history and the future of the human rights education in the universities of China (Zhongguo Gaoxiao Renquan Jiaoyu de Huimou yu Zhanwang). *Human rights (Renquan)*, No. 5, pp. 30-32.
10. Liu, S.P. , Zhou, Y.Q. (2014). On the national human rights action plan and the enforcement of human rights education in the universities in mainland China (Guojia Renquan Xingdong Jihua yu Woguo Renquan Jiaoyu zai Gaoxiao de Shishi). *Hunan Social Science (Hunan Shehuikexue)*, No. 3, pp. 215-219.
11. Oud, M. (2006). Creative tensions and the legitimacy of human rights education – a discussion on moral, legal and human rights education in China. *Journal of Social Science Education*, Vol. 5 No. 1, pp. 117-125.
12. Tang M.Y.(2001). Human Rights Education in Schools: The Curriculum Development and Teachers Training Program in Taiwan. Retrieved 06.05.2017 from http://www.scu.edu.tw/hr/research_imgs/mei.pdf.
13. The Ministry of Education of Taiwan.(2001). Spread the Seeds of Human Rights, Create an Environment of Human Rights Preservation. pp31-34.

THE FUTURE OF FREEDOM OF MOVEMENT OF ECONOMICALLY INACTIVE UNION CITIZENS

Solange Maslowski
Center for Comparative Law, Czech Republic
maslowsk@prf.cuni.cz

ABSTRACT

Despite of its uncontestable success, the fundamental right of freedom of movement has been last years questioned by a number of host Member States. This new approach occurred following the occurrence of events such as the enlargement of the EU to economically poorest countries from Central, Eastern and Southern Europe, the global financial crisis and indirectly, the migration crisis. Despite of the existing legal limits and large leeway of Member States in restricting this right, some Member States are of the opinion that the current provisions are too liberal and endanger their national interests. They would welcome reforms in order to fight against abuses of rights (so called social tourism), to limit access to social assistance and to preserve their national public policies. Similarly, the Court of Justice of the European Union (CJEU) is reflecting on this issue and recently changed its former generous approach by allowing Germany not to confer social assistance to inactive citizens (Dano 2014, Alimanovic 2015 and Garcia-Nieto 2016). These restricting measures are mainly targeting economically inactive Union citizens on the move, seen by their host Member State as potential unreasonable burdens on their public finance and services. This question has been also at the heart of the Brexit referendum and will be a key part of the Brexit negotiations. The aim of this article is to reflect and foresee next direction for freedom of movement between a backward steps rights-narrowing (supported by some host Member States), a statu quo (relying on differential treatment for economically inactive citizens) or a pursuit of EU integration towards a more European social model and a single Union citizen statute.

Keywords: *Brexit, Equality of treatment, Freedom of movement, Inactive citizens, Social tourism, Union citizen*

1. INTRODUCTION

Freedom of movement has been built progressively since the foundation of the European Economic Community in 1957, starting with the freedom of movement for workers[1], expanding to all Union citizens in 1993[2] and enlarging to the citizens of new Member states from Eastern, Central and Southern Europe during the 21th century[3].This expansion of the mobility of Union citizens has been possible thanks to the granting of the citizenship of the Union to all national citizens of the Member States by the Maastricht treaty. This Union citizenship was accompanied by different rights, the most important being the freedom of movement and residence. Aware of their rights, more and more economically inactive Union citizens are using their right of freedom of movement to escape critical economic situation into their Member State of origin. They usually move from weakly economically Member States to economically more successful Member States with the hope to find a job and a better situation.

[1] At its beginning, freedom of movement of workers was concerning around 233.2 million persons.
[2] Ex-article 8a TEU (today 21.1 TFEU) has provided freedom of movement and residence for every Union citizen independently of its social status (worker or economically inactive resident).
[3] After the last enlargement in 2013, freedom of movement of persons is concerning around 506, 9 million persons, twice more persons than at the beginning of freedom of movement of workers.

The presence of economically inactive Union citizens in their territory has recently provoked strong political pressure in some Member States to reconsider the benefits of the principle of free movement.
This restrictive approach has arisen against the background of the global economic crisis, which occurred just after the enlargements of the EU, leading to more nationalistic and protectionist measures, which have legal consequences for Union citizens on the move. Existing limitations to the right of movement and residence in case of threat to public policy, public security and public health, of abuse of rights and of unreasonable burden on the social assistance system of the host Member state seem not to satisfy anymore some Member States (Chapter 1). The questioning of the fundamental right of freedom of movement of persons shows the necessity to rethink the concept of freedom of movement of persons in a context of post-enlargement and crisis. Different ways are possible (Chapter 2).

2. THE QUESTIONING OF FREEDOM OF MOVEMENT OF ECONOMICALLY INACTIVE UNION CITIZENS

The 21rst century is facing a different political, economic and societal context than the first years of freedom of movement of workers in the years fifty. This new and challenging context is producing new approaches and reactions from the main actors of this fundamental rights, Union citizens, host Member States and European institutions.

2.1. A new context

New factors such as the last enlargements of the European Union to economically poorer Member states from Eastern, Southern and Central Europe, the occurrence of the global economic crisis and of the migration crisis and recently, the Brexit as well as the reinforcement of national populistic movements in Europe have deeply changed the picture of freedom of movement of Union citizens during the 21th century.

2.1.1 The last enlargements to CEEC and the global economic crisis

The last enlargements of the EU to CEEC (mainly 2004 and 2007) led to the migration of poorer migrants to older Member States. It automatically led to the fear of abuses of rights, and consequently to more nationalistic and protectionist measures, affecting Union citizens on the move.To prevent massive migration of Central-Eastern citizens endangering the local job market and the national social security system, older Member States used transitional regimes after the last enlargements of the EU. Similarly, the world economic and financial crisis led to the migration of poor migrants from Southern and Eastern countries to economically richer Member States. Receiving countries, already burdened by an increasing number of unemployed nationals and by a diminution of tax revenues, see them as potential abusers. Additionnaly, the economic crisis conduced to the loss of jobs of already installed working migrants who became suddenly economically inactive in their host Member States. In some Member States, students without sufficient financial resources, former workers who have lost their jobs because of the economic crisis or personal events, poor people are being expelled just because of their lack of self-sufficiency (which might be just temporary).

2.1.2 Brexit and the rise of national populistic movements

The Brexit referendum has focused a lot on the limitation of freedom of movement of persons and especially on the limitation of access to social assistance for Union citizens residing in the UK. In 2016, Mr. Cameron was requiring for a limitation of the conferral of social

assistance for all Union citizens during the first four years of their residence (including workers who would lose their right to equality of treatment)[4].
The Brexit negotiations are generating big doubts about the future of migrant workers in the United Kingdom and of British migrants abroad. Furthermore, last and present years are facing many internal public debates regarding the access to social assistance for Union migrants. In 2014, many German towns complained that their social services were unable to cope with the massive influx of unemployed people from Eastern Europe. CDU general secretary of the time had even proposed not only to expel abusers of right but also to prevent them from returning to Germany. A German bill even proposed a loan for a ticket home for unfortunate applicants in 2016 and another one proposed the diminution of the amount of social assistance dedicated to Polish migrants in Germany in early 2017![5]
Moreover, the refugee crisis also contributed indirectly to protectionist measures against migrants in general as host Member States are fearing for their national budget.

2.2 A new approach

The new context of freedom of movement of Union citizens has led to new approaches both from the Member States and from European institutions confronted with the delicate task of striking a balance between facilitating the exercise of free movement rights with preserving the effetive functioning of Member States social security systems (Guild, 2014)[6].

2.2.1 Complaints from Member States

The present decade has faced strong national reactions against Union citizens, until now reserved to third-country nationals. Collective expulsions of Union citizens in France in 2010 have aroused again several international reactions[7]. Some years later, Belgium was also expelling thousands of non-self-sufficient Union citizens[8]. Application to social assistance during a stay of more than 3 months is, in practice, risky for economically Union citizens as certain Member states often consider the recourse to social assistance as a failure to comply with the self-sufficiency requirement and then terminate the residence's right[9]. However, the Court of Justice repeatedly and Directive 2004/38/EC (article 14-3) stated that in no case an expulsion measure shall be the automatic consequence of an Union citizen's recourse to the social assistance system of the host Member State.
In 2013, the ministers of Interior of Germany, Austria, the UK and the Netherlands have written a joint letter to the Irish presidency[10]. They were requiring for the amendment of Directive 2004/38/EC because of the abuse of social assistance by Union citizens viewed as welfare tourists.

[4] For more details, see SEELEIB-KAISER M., The new 'settlement' for the UK – EU Citizens, Social Rights and Brexit, 2016, Beucitizens.
[5] See, for example, Niemcy tną zasiłki dla obcokrajowców. Pobierają je przede wszystkim Polacy. Stracą 100 euro, Adriana Rozwadowska, 10.2.2017, online: http://wyborcza.pl/7,155287,21358998,niemcy-tna-zasilki-dla-obcokrajowcow-pobieraja-je-przede-wszystkim.html
[6] Guild E., Peers, S., Tomkin, J., The EU citizenship directive, A commentary, Oxford University Press, 2014.
[7] See e.g. CHASSIN, C.-A., Le droit français et la protection des Roms, CRDF, pp. 135-146, 2010 ; FAURE ATGER, Anais, EGGENSCHWILER, Alejandro, Les Roms, révélateurs des anomalies d´un "Espace de liberté, de sécurité et de justie au servie des citoyens", Cultures et Conflits, n°81-82, printemps/été 2011, p. 195-201.
[8] In 2013, 2712 EU citizens, including long-term residents, were returned to their home countries by Belgium, fearing for its social assistance system.
[9] In the Grzelczyk case, the Court had already stated that in no case may such measures become the automatic consequence of a student having recourse to the host Member state's social assistance system.
[10] See Joint letter from the Federal Minister of the Interior of Austria, the Federal Minister of the Interior of Germany, the Minister for Immigration of the Netherlands and the Secretary of State for the Home Department of United Kingdom to Commissioners Reding, Malmstrom and Andor, online http://docs.dpaq.de/3604-130415_letter_to_presidency_final_1_2.pdf.

2.2.2 The CJEU's stricter approach

The Court of Justice contributed greatly to grant equality of treatment to economically inactive Union citizens by relying on their Union citizenship (Martinez Sala, Grzechyk). Its approach was much more generous than existing EU primary and secondary law. It interpreted restrictively the exceptions referred in article 24.2 of Directive 2004/38/EC and it also recognized that EU law allows for a certain degree of financial solidarity. Nevertheless, last November 2014, the Court changed this generous approach in the Dano's case[11] by stating that a Member State must have the possibility of refusing to grant social benefits to economically inactive Union citizens who exercise their right to freedom of movement solely in order to obtain another Member State's social assistance although they do not have sufficient resources to claim a right of residence. Similarly, it stated in the Alimanovic case (2015) that a Member State may exclude Union citizens who go to that State to find work from certain non-contributory social security benefits[12]. Very recently, in the Nieto case (2016), it decided that Germany was allowed to refuse social assistance to an economically inactive Spanish citizen residing for less than 3 months in Germany[13].The recent development of the jurisprudence of the CJEU seems to be moving away from its generous approach in terms of social assistance, by allowing Member States not to confer social assistance to inactive citizens.

2.2.3 The defense of freedom of movement of persons

Reacting to the Member States' complaints and to the expulsions of Union citizens, the European Commission and the European Parliament have expressed themselves towards the preservation of Union citizenship and fundamental rights. They regularly publish non-binding guides such as communications to help Member States to implement well the Citizenship directive[14] and order national studies to check the state of freedom of movement of Union citizens in the EU and the potential existence of abuse of this right[15]. Both European institutions criticized the Member States stating that national discourses and complaints are rarely backed with figures and datas. Despite the claims of some Member States, the European Commission until now refused to amend Directive 2004/38/EC.

3. WHICH DIRECTION FOR FREEDOM OF MOVEMENT OF PERSONS IN THE EU?

The questioning of the fundamental right of freedom of movement of persons calls for a new direction between a backward steps rights-narrowing (supported by some host Member States), a status quo (relying on differential treatment for economically inactive citizens) or a pursuit of EU integration towards a more European social model and a single Union citizen's statute.

3.1 A Statu quo (existing situation)

Directive 2004/38/EC, while not mentioning expressly economically inactive Union citizens clearly, distinguishes between the rights of the workers and those of economically inactive Union citizens who seem to be considered as a subsidiary category to the category of workers.

[11] Case C-309/13 Elisabeth Dano, Fliorin dano v. Jobcenter Leipzig (2014) OJ C 226.
[12] Jobcenter Berlin Neukölln v Nazifa Alimanovic and Others, Case C -67/14.
[13] Vestische Arbeit Jobcenter Kreis Recklinghausen v Jovanna García-Nieto and Others, Case C-299/14.
[14] COM (2009) 313 final: Communication from the Commission to the European Parliament and the Council on guidance for better transposition and application of Directive 2004/38/EC on the right of citizens of the Union and their fam ily members to move and reside freely within the territory of the Member States.
[15] COM(2013) 837 final: Communication from the Commission to the European Parliament, the Council, the European economic and social Committee and the Comittee of the Regions: Free movement of EU citizens and their fa milies: Five actions to make a difference

3.1.1 Limited residence's rights

The freedom of movement of economically inactive Union citizens is barely total during the first three months of stay because short-term stay is permitted without conditions (upon a valid ID or passport).

Stays more than 3 months are conditional for economically inactive Union citizens. According to article 7 of Directive 2004/38/EC, economically inactive Union citizens who want to stay more than three months have to fulfill two main requirements:

- The possession of sufficient financial resources to support themselves and their family members (article 7-2 and article 8-4), the aim being not becoming an unreasonable burden for the host Member State[16]. Students are here privileged because a simple declaration of self-sufficiency or equivalent is accepted in their case while other economically inactive citizens have to prove their self-sufficiency (art.7.1c).
- The possession of comprehensive sickness insurance. The insurance's form (private or public) and origin (from the host Member state or another State) are not relevant as far as the insurance covers the territory of the host State and provides for a comprehensive coverage[17].

The directive is also foreseeing special provisions targeting a special category of economically inactive Union citizens.There is a special provision in article 14-4 for economically inactive Union citizens who are job-seekers in the host Member State. As far as they are seeking employment and have a genuine chance of being engaged, they benefit from the right of residence and should not be expelled. Article 7 has also a special provision for students. They benefit from a right of residence of more than three months as far as they are enrolled at a private or public establishment, accredited or financed by the host Member State.

Concerning the last type of residence, the permanent residence, economically inactive Union citizens who wish to benefit from it should demonstrate a legal stay for a continuous period of five years in the host Member State. Exceptionally, the permanent residence can be granted before five years of residence if the Union citizen is fulfilling the conditions of article 17 of Directive 2004/38/EC (for example, an old-age pensioner who is a former worker for a certain period in the host Member state). Existing EU legislation is already restrictive for economically inactive Union citizens. As the Commission has already proposed, unhappy Member States have the possibility to use the restrictive provisions of EU secondary law.

3.1.2 Limited access to social assistance

Granting social assistance rights to Union citizens on the move, with the exception of workers, has always inspired the reluctance of Member states, frightened to burden their national social security system. Indeed, social benefits and migration have a contested relationship that constitutes a policy challenge in the EU[18]. Last years, this fear has been increased by the concern of social tourism.

[16] Member States are free to determine the amount of sufficient resources but may not lay down a fixed amount. This amount should not exceed the minimum amount that would permit an individual to exist without recourse to social assistance. When this criterion is not applicable, the amount shall not in any event exceed the minimum social security pension paid by the host State. Resources can be put at disposal by a career or other third party. Member states must also take into account the personal situation of the person. Generally, the requirement of sufficient resources has to be interpreted narrowly and to comply with the principle of proportionality. It should not undermine the spirit of the directive.

[17] A comprehensive coverage could be understood as coverage for general health risks and not for all risks as the Court stated in the Baumbast's case.

[18] See E. Guild, S. Carrera, K. Eisele, Social Benefits and Migration: A contested relationship and Policy Challenge in the EU, CEPS 2013, pp. 62-82 and 128-143; ICF GHK, A fact finding analysis on the impact on

Primary and secondary Union law is also privileging the workers in this field and protecting Member states against possible abuses of their rights by Union citizens[19].
As Jean-Claude Barbier has already said, despite far-reaching Europeanization, access to social protection has, since the Treaty of Rome in 1957, remained firmly national[20] and EU law still does not treat economic and social rights in an equivalent way[21]. Most of the texts establishing social rights concern the workers (Regulation 883/2004 on the coordination of social security systems, Community Charter of fundamental social rights for workers from 1989) with the exception of the Charter of fundamental rights from 2000[22] which includes also the economically inactive Union citizens.

3.1.3 No equal treatment

The citizenship directive itself does not provide a full equality of treatment to all Union citizens moving to another Member state. Indeed, this equality of treatment claimed by article 24.1 of Directive 2004/38/EC[23] and by article 18 TFEU (no discrimination on the basis of nationality) is still virtual in many areas.The proclamation of equality of treatment at Article 24.1 is in fact jeopardized by the second point of this article which states special derogations to this general principle.These derogations are mainly targeting economically inactive citizens. Their access to social assistance and to maintenance aid for studies is limited during the first three months or more or before they acquire the permanent residence.
There is a clear tension between the declaration of equality of treatment of Article 24-1 and of Article 18 TFUE on one side, and the limitations of the right to access to social benefit and other provisions, on the other side. Despite the first efforts of the Court of Justice of the European Union to equalize the rights of Union citizens on the move against nationals of the host Member state, inactive Union citizens on the move are a kind of "under-class" citizens[24] who are certainly being "discriminated":
• on one hand, against nationals as far as social assistance is concerned because nationals are entitled to social assistance without any time limit.
• and on another hand, against workers on the move as far as the right of residence is concerned, these latter benefiting from an automatic right of residence.
• Similarly, against workers and nationals as far as expulsion is concerned as, according to Recital 16, in no case should an expulsion measure be adopted against workers, self-employed persons or job-seekers as defined by the Court of Justice save on grounds of public policy or public security. Moreover, in no case also, nationals of Member states could be expel from their home State.
Moreover the self-sufficiency criterion allowing an economically inactive Union citizen to reside in a host Member state is depending on national rates (eligibility for social assistance

the Member States' social security systems of the entitlements of non-active intra-EU migrants to special non-contributory cash benefits and healthcare granted on the basis of residence, 2013.
[19] This is clear when we have a look at Recital 16 and at article 14 of Directive 2004/38/EC which state that Union citizens benefit from a residence right and should not be expelled as long as they do not become an unreasonable burden on the social assistance system of the host Member State.
[20] Jean-Claude Barbier, To what extent can the European Union deliver « social citizenship » to its citizens? in Social policy and citizenship, Oxford University Press, 2013, p. 97.
[21] Idem, p. 99.
[22] The fact that this document does not apply to the United Kingdom and limitedly to Poland and the Czech Republic also diminishes the scope of its role as a promotor of social rights.
[23] Article 24.1: Subject to such specific provisions as are expressly provided for in the treaty and secondary law, all Union citizens residing on the basis of this Directive in the territory of the host Member state shall enjoy equal treatment with the nationals of that Member state within the scope of the treaty.
[24] See Jean-Philippe Lhernoud, Non-discrimination en raison de la nationalité en matière sociale in Francette Fines, La non-discrimination entre les Européens, Ed. Pedone, Paris 2012, p. 230.

or for social security system) which are variable from one Member State to another one. The right of residency of economically inactive Union citizen is therefore not uniform in the 28 Member states. This differentiation is also questioning the equality of treatment of these inactive migrants.

3.2 A backward step rights narrowing

This backward step rights narrowing matches some Member States' approach and would require to cancel part of the acquis communautaire of freedom of movement of Union citizens.

3.2.1 Limiting residence and social rights for economically inactive citizens

Economically inactive Union citizens are considered by some Member States as abusers of rights or unreasonable burdens on the national social assistance system or even as a danger for the national public policy. Therefor, they are claiming for a return to earlier times where freedom of movement was opened only to self-sufficient persons, preferably workers.
They are also afraid of a massive migration of poor citizens, who will claim for social assistance without the intention to work (social tourism) and will behave not properly (begging, stealing, illegally occupying land). They are asking for a reform of the freedom of movement of persons that would consists in a stricter legislation limiting the migration of inactive persons, their access to social assistance and in more effective sanctions against social tourists or other offenders. It seems that preventive measures such as the transitional regimes[25] and the existing national laws limiting access to social assistance[26] are considered as not sufficient.

3.2.2 Reinforcing restrictions

The 2013 letter of Five ministries of Interior to the EU Presidency was relating to a fraudulent use of the right of freedom of movement and was requiring for more sanctions, such as easier expulsions and re-entry bans. The content and the tone of the letter has chocked many defenders of the fundamental right of freedom of movement. Indeed, it undermines the whole concept of EU citizenship and the fundamental right of freedom of movement, as it addresses Union citizens with concepts and words used normally for third-country nationals and it develops a stricter punitive approach (Pascouau, 2013)[27]. This way would favorise expulsion of Union citizens while this sanction should be used very exceptionnally.

3.3 A pursuit of EU integration towards a more European social model

3.3.1 A European social model

In the Grzelcyck case, the Court of Justice reminded that a certain degree of financial solidarity between nationals of a host Member State and nationals of other Member States should prevail, particularly if the difficulties encountered are temporary. The Dano, Alimanovic and Nieto cases seem to have forgotten the concept of solidarity which is undermined by the ambiguity and vagueness of many legal institutes related to economically inactive Union citizens. Would it be possible to soften the concept of lawfulness of residence of economically inactive Union citizens? Economically inactive Union citizens non-self-

[25] After the last enlargements to the CEEC, older Member States used transitional regimes to reduce the possibilities of applying to local jobs and to social benefits for new Union migrants.
[26] Member States are often limiting access to social assistance to foreigners by the adoption of restrictive national laws. Restrictions can take the form of a limitation of access to social assistance to long-term residents, an habitual test residence, a right of residence test or special checks by immigration authorities or even a language test.
[27] PASCOUAU Y., Strong attack against the freedom of movement of EU citizens: turning back the clock, Commentary, EPC, 30.4.2013.

sufficient could benefit from a lawful residence as far as they are not a burden for the social assistance system of the host Member state. National budgets of the host Member states would not be put in danger. Another solution, which is a far much ambitious way, would be to give a more dense meaning to the citizenship of the Union including a social citizenship?[28] Such an evolution would require the political will of the Member States to develop further the content and scope of the citizenship of the Union. However such a big step would participate to the realization of one of the objective of the European Union and of the Charter of fundamental rights which is combating social exclusion.

3.3.2 A single Union citizen's status

Many steps have been taken to facilitate Union citizens' entry to and residence since 1957. The status of Union citizens residing in a host Member State is becoming increasingly similar to that of nationals of the host Member State, even if total equality of treatment is still not possible in some areas, such as social assistance. It would be also fruitful to explore more the compatibility of the exceptions to equal treatment with the Charter of fundamental rights of the European Union. Indeed, we can ask ourselves to what extent the "differential treatment" of economically non-active Union citizens is compatible with the concept of a European citizenship and of all the fundamental rights linked to it.In the Dano case, the German court posed one important question to the Court of Justice that unfortunately did not receive any answer. The question was: To what extent the refusal of social assistance to non-economically active Union citizens respects Articles 1 (human dignity) and 20 (equality before the law) of the Charter of fundamental rights of the European Union?

4. CONCLUSION

The current European crisis and the growing number of economically inactive migrants require new solutions, acceptable for all the parties involved, to avoid a dangerous backward step and the loss of the acquis in matter of freedom of movement of persons. There are more and more national populistic behaviours in the Member States, that put into danger the fundamental right of freedom of movement. The Brexit campaign has proved that freedom of movement of persons is a key element of the European integration or disintegration. Very fundamental aspects of the fundamental right of freedom of movement have been questioned. It is of great importance to rethink the freedom of movement of persons and to address its weakest element, the economically inactive Union citizens.Three ways are possible, a statu quo maintaining existing rights and obligations, a backward step rights narrowing favored by some Member States or the pursuit of European integration in this field. According to me, the second solution is not conceivable and the third solution does not have any future if two types of essential legal institutes are not better defined and unified at the European level: first the legal ground justifying expulsions of Union citizens (unreasonable burden, threat to public policy and abuse of rights) as well as institutes conditioning the legality of the residence of economically inactive Union citizens such as self-sufficiency.

ACKNOWLEDGEMENT: *This article has been supported by the Czech Science Foundation – GAČR through its project N. 15 - 23606S Selective Issues Deriving from the Transposition and Implementation of Directive 2004/38/EC*

[28] See B. Bercusson, Manifesto for a social Europe, European Law Journal, 3(2), pp. 189-205. See also Christoph Schonberger, European Citizenship as Federal Citizenship. Some Citizenship Lessons of Comparative Federalism, Revue Européenne de Droit Public, Vol. 19, Nb. 1, 2007, pp. 61-81. In this last article, Christoph Schonberger reminds that Federal citizenship in the United States really came true when all federated States agreed not only on the free movement of the poor citizens of the other States but also on their access to social assistance.

LITERATURE:

1. Barbier, J-C. (2012). To what extent can the European Union deliver « social citizenship » to its citizens? In *Social policy and citizenship:The Changing Landscape* (Evers, A. and Bercusson, B. et al. (1997). Manifesto for a social Europe. *European Law Journal*. 3(2).
2. Case C -67/14. (2015). *Jobcenter Berlin Neukölln v Nazifa Alimanovic and Others*.
3. Case C-184/99. (2001). *Judgment of the Court of 20 September 2001. - Rudy Grzelczyk v Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve*.
4. Case C-299/14. (2016). *Vestische Arbeit Jobcenter Kreis Recklinghausen v Jovanna García-Nieto and Others.*
5. Case C-309/13. (2014). *Elisabeth Dano, Fliorin dano v. Jobcenter Leipzig*.
6. Chassin, C.-A. (2010). Le droit français et la protection des Roms. *CRDF*, 2010 (no 8),
7. COM (2009) 313 final. (2009).*Communication from the Commission to the European Parliament and the Council on guidance for better transposition and application of Directive 2004/38/EC on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States*.
8. COM (2013) 837 final. (2013). *Communication from the Commission to the European Parliament, the Council, the European economic and social Committee and the Committee of the Regions: Free movement of EU citizens and their families: Five actions to make a difference.*
9. Faure, A., Eggenschwiler, A. Alejandro. (2011). Les Roms, révélateurs des anomalies d´un "Espace de liberté, de sécurité et de justie au servie des citoyens". *Cultures et Conflits*, printemps/été 2011 (n°81-82), p. 195-201. Retrieved 12.5.2017 from https://conflits.revues.org/18148
10. Guild, E, Peers, S, Tomkin, J. (2014). Oxford University Press.
11. Guild, E., Carrera, S., Eisele, K. (2013). *Social Benefits and Migration: A contested relationship and Policy Challenge in the EU.* CEPS 2013.Retrieved 12.5.2017 from https://www.ceps.eu/publications/social-benefits-and-migration-contested-relationship-and-policy-challenge-eu
12. Guillemard, A-M.). Oxford: Oxford University Press.

a. http://docs.dpaq.de/3604-130415_letter_to_presidency_final_1_2.pdf.

13. ICF GHK. (2013). *A fact finding analysis on the impact on the Member States' social security systems of the entitlements of non-active intra-EU migrants to special non-contributory cash benefits and healthcare granted on the basis of residence*. Retrieved 12.5.2017 from http://csdle.lex.unict.it/docs/labourweb/A-fact-finding-analysis-on-the-impact-on-the-Member-States-social-security-systems-of-the-entitlemen/4470.aspx
14. *Joint letter from the Federal Minister of the Interior of Austria, the Federal Minister of the Interior of Germany, the Minister for Immigration of the Netherlands and the Secretary of State for the Home Department of United Kingdom to Commissioners Reding, Malmstrom and Andor*. (2013). Retrieved 12.5.2017 from
15. Lhernoud, J-P. (2012). Non-discrimination en raison de la nationalité en matière sociale. In Fines, F., *La non-discrimination entre les Européens* (Pedone). Paris
p. 135-146. Retrieved 12.5.2017 from
https://www.unicaen.fr/puc/images/crdf0811chassin.pdf
16. Pascouau, Y. (2013). Strong attack against the freedom of movement of EU citizens: turning back the clock. In *Commentary, EPC*, 30.4.2013. Retrieved 12.5.2017 from http://www.epc.eu/pub_details.php?pub_id=3491
17. Rozwadowska, A. (2017). Niemcy tną zasiłki dla obcokrajowców. Pobierają je przede wszystkim Polacy. Stracą 100 euro. *Wyborcza*. 10.2.2017. Retrieved 10.2.2017 from http://wyborcza.pl/7,155287,21358998,niemcy-tna-zasilki-dla-obcokrajowcow-pobieraja-je-przede-wszystkim.html
18. Schonberger, C. (2007). European Citizenship as Federal Citizenship. Some Citizenship Lessons of Comparative Federalism. *Revue Européenne de Droit Public* (Vol. 19. No. 1.).
19. Seeleib-Kaiser, M. (2016). *The new 'settlement' for the UK – EU Citizens, Social Rights and Brexit*. Beucitizens. Retrieved 12.5.2017 from http://beucitizen.eu/new-settlement-for-the-uk-eu-citizens-social-rights-and-brexit/

CIVIL PROCEDURAL LAW EFFECTS OF THE CONTRACT ON OUT OF COURT SETTLEMENT

Stojana Petrovic
University of Banja Luka, Faculty of Law, Bosnia and Herzegovina
stojana.petrovic@pf.unibl.org

ABSTRACT

Contract on out of court settlement, concluded between the parties in the civil or commercial dispute, primary is an institute of the substantive law, respectively of contract law. On the other hand, the treaty on court settlement is primary an institute of the procedural law. Therefore, in legal theory, but also in the jurisprudence the prevailing view was that contract on out of court settlement does not have any procedural law effects, but only effects in substantive law. The author postulates that treaty on out of court settlement should also have substantive and procedural law effects, the same as the contract on court settlement. Scientific methods used in this paper are intended to check and confirm the hypothesis, respectively; there is no other, more perfect mechanism which would allow a creditor to rely on the safe execution of debtor's duty. This question has not only scientific but also a practical significance, primarily for the parties of the dispute, who choose to resolve their dispute by peaceful means, out of court. The main reason why the issue of procedural effects of the contract on out of court settlement is so important is about the question of possibilities and conditions for the execution of the contract. This, further, affects the motivation of the parties to opt for the peaceful settlement of their dispute before they file a lawsuit before the court. The legal position of the parties in the dispute is more secure and also more certain, if any of them can count on procedural effects of the concluded contract on out of court settlement, primary on the effects in the enforcement procedure, in terms of its treatment as an enforceable document. The author concludes that its procedural effects can be identified but under certain conditions.

Keywords: *contract on out of court settlement; execution of contract on out of court settlement; executive document; procedural effects*

1. INTRODUCTION

The conflict implies disagreement or opposition of interests or ideas. The conflict is defined as a situation in which they are perceived interests of the people to the extent pitted against it is impossible to completely satisfy everyone.[1] When the conflict, of everyday life, is transferred to the field of law, then it gets its legal qualification of the dispute.[2]

From the parties to the dispute depends on whether the case will be resolved before the court in litigation, or one will resort to one of the non-judicial methods of its resolution. For the purposes of the research in this paper, the author's attention will be focused on mediation, as alternative dispute resolution methods.

At the outset, a distinction should be made between judicial and non-judicial mediation. The procedure of court mediation, as same as the procedure of out of court mediation process is implemented under a special law rules of the mediation process. The difference is primarily in the procedural effects of mediation agreement.

---

[1] Bühring-Uhle, C, Kirchhoff, L, Scherer, G. (2006), *Arbitration and Mediation in International Business,* Kluwer Law International, p. 132.

[2] Knežević, G. (2006), *Pravo i promene: ADR – promena u pravu,* Annals of Faculty of Law, Belgrade, no. 2, p. 132.

Making the distinction between these two types of mediation should answer the question whether it is justified to recognize the procedural facts only to the contract of court settlement, but not to the contract of out of court settlement. The general rule provides the enforcement power to the contract of court settlement.[3] On the other hand, in theory, but in practice were "controversial" procedural effects of contracts of out of court settlement of the parties.[4] Scientific methods used in this paper are intended to confirm the initial hypothesis that the agreement of out of court settlement (should) have not only substantive, but also procedural effects. Since the confirmation of the initial hypothesis depends on whether it will be confirmed sub-hypotheses, concerning the causal link between the motivation of the parties to resolve their dispute in mediation out of court, and the strength of procedural effects of contract out of court settlement. It also affects the sub-hypotheses about the lack of adequate legal instruments executing the out of court settlement, which would be different from the performance of any other agreement of contract law or court decision.

2. THE COURT MEDIATION AND/OR COURT SETTLEMENT AND OUT OF COURT MEDIATION

Under the mediation means a procedure in which a third neutral party (mediator) assists parties in an effort to reach a mutually acceptable solution to the dispute.[5] From the above legal definition it is clear that the mediation process, if carried out outside the court, relevant only if it is carried out according to the procedure, which is regulated by a special law. In addition, in the mediation procedure is involved a third neutral party, which is not in parties 'dispute. The mediator does not decide by a formal decision, in terms of determining which of the parties has more right, but helps them to independently reach a mutually acceptable solution to the dispute. This implies a maximum engagement of the participants of the dispute in order to achieve its dismissal. Moreover, the very decision of the parties to participate in mediation procedure to resolve the dispute, in fact is an essential step towards a friendly and voluntary resolution of the dispute. In some of the countries of our Region, distinguishing between non-judicial mediation and the court settlement is made possible only by adopting specific legislation on mediation. Before that, the matter of mediation procedure was regulated by the provisions of substantive law on obligations.

[3] art. 91 par. 1. Code of Civil Procedure of Republic of Srpska („Službeni glasnik Republike Srpske", no. 58/03, 85/03, 74/05, 63/07, 49/09, 61/13), *hereinafter referred to as* ZPP RS. The same procedural effect is recognised to the court settlement in any other county of the Region and Europe.

[4] *In this sence to compare* Marković, V. (2015), *Ugovor o poravnanju,* Proceedings to the International Scientific Conference on IT and Business-related Research, Synthesis, p. 732. *Also to compare* Supreme Court's Decision Gzz no. 119/01, 22.02.2001.

[5] art. 2 par. 1. Law on Mediation Procedure of Bosnia and Hercegovina („Službeni glasnik Bosne i Hercegovine", no. 37/04), *hereinafter referred to as* ZPM BiH (2004). The legislator in Serbia uses the technical term *intervention*, and in the Law on Intervention in Resolving Disputes („Službeni glasnik Republike Srbije", no. 55/14), *hereinafter referred to as* ZP Sr (2014), defining the art. 2 under term *intervention*, stipulates that it is a procedure in which parties voluntarily seek to resolve contentious relationship through negotiations, with the help of one or more intermediaries, which helps the parties to reach an agreement. The legislator in Croatia used the technical term *conciliation*, and in the Law on Conciliation ("Narodne novine", no. 18/11), *hereinafter referred to as* ZM Hr (2011) similarly provides that it is a procedure in which the parties to the dispute try to resolve the dispute.

It is interesting to note also that the legislator in Serbia, although dealing with standardization of rules of the mediation procedure in ZP Sr (2014) actually uses the substantive term *sides to the dispute*. Thus the legislator in art. 2 appoint participants in the mediation procedure by technical term *sides*, by the criteria of their participation in the dispute substantive respect. The legislator in Bosnia and Herzegovina and in Croatia appoint the participants of the process of mediation *parties to the dispute*, which gives primacy to the capacity of persons as *parties* in the mediation *procedure*, or in conciliation proceedings, but not to their capacity as participants in the conflict, as a substantive relationship.

Procedural point of view, before the law on mediation in each of the country of the region this matter was covered by the provisions of civil procedural law and exclusively as the procedure of a court settlement with the cooperation of judges. Therefore, in theory, justifiably, emphasized that the agreement on non-judicial mediation does not have and cannot have procedural effects, primarily the effect of enforceable document, because the enforceable document were exhaustively listed, and there was no special law to award the contract on the out of court settlement in mediation as enforceable document.[6]

The term of *judicial mediation* is not formally legal grounded, but it could theoretically be derived from the fact that the process of peaceful settlement of the conflict may lead before the court, as adhesion to litigation procedure flowing between the parties, and with the cooperation of judge as mediator. The conciliation procedure before the court in this form of acknowledges the Croatian legislation.[7] The law expressly provides that, under the mediation means any process, regardless of whether is it carried out before the court, an institution for conciliation, or outside of them, in which the parties try to resolve the dispute by agreement. [8] In addition, the legislator in Croatia prescribed that mediation before the court takes the *conciliator*, determined from a list of conciliators, determined by the *President of the Court*.[9]

Entity legislation in Bosnia and Herzegovina, as well as legislators in Serbia, does not provide expressly court mediation. In fact, when it comes to the entity legislation of Bosnia and Herzegovina, and viewed primarily in terms of the provisions of the Civil Procedure Act of Republic of Srpska, it is *explicite* ruled mediation *and* court settlement as two separate notions. One can assume that the legislator under the concept of mediation meant primarily out of court, guided by the mediator and not the judge, and under the term of court settlement, legislator meant court mediation, directed by the judge.[10]

The legislator also suggests that the court *may*, *at the latest at the preparatory hearing*, if it deems it appropriate given the nature of the dispute and other circumstances, to submit to the parties to resolve their dispute in mediation as provided for by a special law.[11] This provision could draw the conclusion that in that mediation procedure took part mediator, not judge, as, after all, lays down in provisions of ZPM BiH (2004), to which directs the provisions of the ZPP RS. On the other hand, court settlement could be concluded before the court throughout the civil procedure until its final disposition.[12]

The legislator in Bosnia and Herzegovina provides that the mediator is a person who meets the general requirements for employment - a university degree, completed the training program to the Association of Mediators, and recorded in the register of mediators.[13] Also, it is essential that the mediator is a neutral third party, beyond dispute. All these conditions must be simultaneously and cumulatively met. *Stricto sensu* interpretation of the provisions of the ZPM BiH (2004) and the provisions of the ZPP RS, no one could conclude that the judge may conduct the mediation procedure. Although the judge fulfills the formal requirements for the performance of mediation, the legislator stipulates only that the judge

[6] *To compare* Karamarković, L. (1996), *Sudsko i vansudsko poravnanje*, Pravni život, no. 12, p. 456.
[7] Thus, and expressly is provided that the court may throughout the civil proceedings propose to the parties to resolve their dispute *in mediation* proceedings *in court* or *out of court.* (art. 186d par. 1. Code of Civil Procedure of Croatia („Narodne novine", no. 53/91, 91/92, 58/93, 112/99, 88/01, 117/03, 88/05, 02/07, 84/08, 123/08, 57/11, 148/11, 25/13, 89/14), *hereinafter referred to as* ZPP Hr).
[8] art. 3 par. 1. ZM Hr.
[9] art. 186d par. 3. ZPP Hr.
[10] *See* art. 86 and art. 87 ZPP RS.
[11] art. 86 ZPP RS.
[12] art. 86 ZPP RS.
[13] art. 31 par. 1. and par. 2. ZPM BiH (2004). The same conditions are prescribed by the legislator and in Serbia, while in Croatia legislator has not deliberately specified the conditions for engaging in mediation by the provisions on ZM Hr (2011).

may propose to the parties a dispute attempt to resolve through mediation.[14] So, from this provision could not be concluded that the intention of the legislator was to assign a judge in order of persons engaged in mediation, but only to power him to submit to mediation as a method of dispute resolution to litigants. This, after all, derives from the provision, according to which the parties jointly select a mediator, from the list *established by the Association of Mediators*.[15]

The legislator in Croatia generally identified court mediation with the process that takes place before the court and with the cooperation of judges as mediators. In his capacity as mediator, in *conciliation procedure before the court* may appear the judge, if one of the parties to the dispute initiated civil proceedings before the court in order to solve the dispute. In this case, the court mediation procedure leads a *conciliator*, determined from a list of conciliators, determined by the *Court President*.[16] The contract on dispute resolution concluded in mediation before the court has the character of a court settlement. [17] In addition, the legislator specifies the *possibility* for the court to submit that the litigants resolve their dispute in mediation proceedings in court or out of court, *throughout the civil proceedings*.[18]

The legislator in Serbia chose the middle ground, to which the judge can carry out mediation between the parties, but *only* after working hours, and at no charge.[19] From these legal provisions arises to the legislator in Serbia formally does not recognize the court mediation, but some of its *sui generis* form, bearing in mind that the judges' affairs on mediation procedure could be conducted *only* after working hours without compensation. *Implicite* interpretation of these legal provisions could be concluded that the legislator in Serbia under the mediation mainly involves an amicable settlement between the parties out of court. In fact, terminologically, he opted for the concept of *court settlement*, while extrajudicial mediation means *mediation.*[20] The role of judges in mediation, formally speaking, exhausted in providing that the judge *will* refer the litigants to mediation or to information session for mediation in accordance with the law, that will indicate the parties on the possibility of an amicable settlement of the dispute by mediation or by other agreed way.[21] Legislator in Serbia does not expressively provide at this point to what moment in a lawsuit the judge will refer the parties to mediation. The provisions of art. 305 ZPP Sr, which is technically located among the provisions governing the maintenance of preliminary hearings, stipulates that the judge will introduce litigants to their right that the dispute can be resolved in a mediation procedure. To be noted is that the judges in Serbia, according to the method of formulating the above legal provisions, are obligated to refer parties to mediation, in accordance with the law at the preliminary hearing.

Formally speaking, it can be concluded at this point that legislators in the observed reference states approach differently to the concept of judicial and non-judicial mediation. The legislature in Bosnia and Herzegovina is not immanent to the concept of judicial mediation, but the concept of mediation as an out of court alternative dispute resolution method, more linked to professional mediators, while parties to the dispute before the court and with the

[14] art. 4 par. 2. ZPM BiH (2004).
[15] art. 5 par. 1. ZPM BiH (2004).
[16] art. 186d par. 2. and par. 3. ZPP Hr.
[17] art. 186d par. 4. ZPP Hr.
[18] art. 186d. ZPP Hr.
[19] art. 33 par. 6. ZP Sr (2014).
[20] *To compare* art. 366 Law on Civil Procedure of Serbia ("Službeni glasnik Republike Srbije", no. 72/11, 49/13 – Decision of Constitutional Court, 74/13 – Decision of Constitutional Court, 55/14), *hereinafter referred to as* ZPP Sr and art. 341, art. 67 par. 1. point 6, art. 158 and art. 340. ZPP Sr. It is interesting to note the inconsistency of the legislator in Serbia, who uses the term *mediation* in the provisions of the ZPP Sr, while the provisions of ZP Sr (2014) speak about the *intermediation*.
[21] art. 11 ZPP Sr.

cooperation of judges can only conclude *court settlement*. Slightly a different solution was adopted in the Croatian law, where the legislator, formally stipulates mediation in the court, and mediation out of the court, where mediation that takes place before the court actually is judicial mediation led by the mediator, determined the list determined by the court president. Serbia has adopted a middle ground, which is still closer to the solution adopted by the Law of Bosnia and Herzegovina, where a judge may participate in mediation as a mediator, but only after working hours without compensation, which implies that such a judge is enabled to lead mediation procedure in which he would be involved outside his judicial office hours, and thus unable to provide to this procedure a feature of court mediation. In this procedure, judge, therefore, participate in a way and like any other mediator, out of court.

At this point, two questions could be raised - first, whether the parties to the dispute, during running litigation, could engage a judge as a mediator to rule the mediation proceedings before the court. If that is possible, would that be a judicial mediation, a court settlement, or non-judicial mediation? Another issue related to the examination of the possibilities that the parties engage court judge, which would be a real and territorial competent for the resolution of their dispute to participate in the proceedings of non-judicial mediation, before the litigation among them. There is no single and unique answer on these questions, given the nuances of a different legal concepts regulating judicial and non-judicial mediation. Namely, in Bosnia and Herzegovina, observing the example of the provisions of the Civil Procedure Act of Republic of Srpska, one could conclude the negative answer to the first question. At the latest at the preliminary hearing, judge *may propose* to litigants to settle their dispute in mediation, *as provided by special law,*[22] or they are enabled to reach an agreement to settle their dispute in mediation until the conclusion of the trial.[23] The specific law, namely the provisions of ZPM BiH does not allow the possibility that the judge conduct the proceedings of mediation between litigants, because the parties to the mediation chose the mediator from the list, established by the Association of Mediators.[24] Therefore, respecting the letter of the ZPP RS, which refers to the provisions of the ZPM BiH, no one could come to the conclusion that the judge may conduct the mediation procedure between litigants. Judge could only suggest the litigants to settle their dispute in mediation, before a mediator, which the litigants selected from the list of the Association of mediators. On the other hand, to litigants remains the possibility of conclusion of a court settlement with the participation of judge.

On the other hand, the legislator in Serbia explicitly regulates the *duty* of the judge to direct the litigants to intermediaries,[25] but also the possibility that the judge may perform mediation process *only* after working hours and without compensation.[26] One can assume that the legislator by this provision had intended to include persons with legal knowledge and

[22] art. 86 par. 1. ZPP RS.
[23] art. 86 par. 2. ZPP RS.
[24] art. 5 par. 1. ZPM BiH.
[25] art. 9 par. 3. ZP Sr (2014).
Unlike legislators in Bosnia and Herzegovina, which gives the judge the option *to suggest* to litigants the procedure of mediation, assessing the appropriateness of such a solution of the dispute (*see* the provision of art. 4 par. 2 ZPM BiH (2004)), the legislator in Serbia imposed a judge's *duty* to litigants to propose them a mediation procedure. (*to compare* the provision of art. 11 ZPP Sr).
[26] art. 33 par. 6. ZP Sr (2014). Not the clearest *ratio* of such legislative solution. Namely, it is clear that the free work of judges in mediation procedure aimed to motivate the sides in the dispute to settle their dispute in mediation procedure, with significantly lower costs. From the aspect of judges, it is difficult to assume that he will be motivated to devote their free time to peaceful settlement of disputes among citizens, without any compensation. The logical solution would be that judges perform mediation procedure without special compensation among the litigants in the course of civil proceedings. But judges 'work on mediation procedure that would be carried out, out of judges' working hours should be additional charged, but at lower tariffs, in order to motivate the disputing parties to settle their dispute with less costs, than would have been the costs of court mediation proceedings, with the participation of judge as mediator.

experience of the judge in the process of non-judicial mediation, but only out of judicial work time, free of charge and exclusively as a mediator, not a judge. Therefore it can be concluded that in this case one could not talk about the court, but only on non-judicial mediation, where judges, solely out of his judicial office hours, can mediate in the settlement of disputes, as well as any other mediator who meets the statutory requirements for it. So, in Serbia parties to the dispute, which are both litigants, could engage a judge as a mediator, and in that case the agreement would have the property of out of court settlement.

In the legislation of Croatia, it is clear that litigants could settle their dispute *in conciliation proceedings before the court*, with the participation of judges as conciliators, where a settlement reached *in conciliation proceedings conducted in court*, according to the explicit legal provision, would have the character of court settlement.[27] Thus, the legislator in Croatia recognized the court mediation, but, in the best interest of the parties, the reached agreement is equated with court settlement.

In light of the other dilemmas set in this work, and which regards the possibility of engaging court judges that would be a real and territorial competent for the resolution of their dispute, as a mediator in the process of non-judicial mediation and if among them is not running litigation, there is also no single answer. Namely, viewed individually by legislative solutions, it could be concluded that in Serbia, the parties to the dispute may engage judge as a mediator before you sue, bearing in mind the provision of the law that leaves the judge the ability to perform mediation procedure only after working hours and without compensation. This is a *sui generis* non-judicial mediation, whereby the judge could participate as a mediator in mediation procedure, but solely out of his working time in which, according to the regular course of things, withdrawing from the position of a judge.

The parties to the dispute, which are not yet in a lawsuit, according to the legislation of Bosnia and Herzegovina would not be able to engage a judge as a mediator in the process of non-judicial mediation, if he is not on the list of the Association of Mediators. This conclusion arises from the *explicite* reference to the law, according to which the parties to the dispute may choose mediators, or from the list of the Association of Mediators. Based on the above legislative provisions, the possibility that the judge participates in the non-judicial mediation exists only if the judge is on the list of mediators of the Association of Mediators. Even that is the case, he would not be in mediation procedure participated as a judge, but only in his capacity as mediator, like any other.

Extrajudicial mediation can be carried out according to the rules of the mediation procedure, regulated by law, or on a completely informal way. The subject of this paper is to study procedural effects of the contract on a non-judicial mediation, conducted exclusively by the rules of the mediation process, as it is legally regulated.

Under extrajudicial mediation, could be considered a process of peaceful settlement of the conflict, which is not carried out at the court, or with the cooperation of judges. In doing so, it is irrelevant, to distinguish the court mediation of non-judicial mediation, whether the civil procedure before the court already started or not. In this regard, one would not conclude that the judicial mediation means any mediation procedure conducted during civil procedure. There is no doubt that the parties to the dispute could be in the process of non-judicial mediation to resolve their dispute before they go to court, or before they acquire the status of litigants. Similarly litigants could, during the civil proceedings before the court, also be in a non-judicial mediation to resolve their dispute. This is corroborated by legal provision, according to which parties in civil proceedings can attach agreement that propose mediation in one of the mediation centers, and the court will suspend the civil procedure until the

[27] art. 186d par. 1. and 4. ZPP Hr.

conclusion of conciliation proceedings *before the conciliation center*.[28] From the above legal provisions, it can be concluded that the fact that the parties to the dispute already have the status of civil litigation parties, legislator does not identify automatically with their participation in the mediation procedure as the procedure of judicial mediation, but he identifies it with the procedure of conciliation before the conciliation center or with mediation proceedings out of court.[29] The same conclusion, but in less precise manner, is stated according to the provisions of relevant laws in Bosnia and Herzegovina and in Serbia.
Initiating the proceedings of out of court mediation, during the litigation, legislator in Bosnia and Herzegovina had unjustified conditioned on previous attempts of litigants to solve the dispute in the non-judicial mediation.[30] The judge conducting the trial may propose to litigants to resolve their dispute by peaceful means in mediation, *if* the parties before initiating court litigation proceedings *have not attempted to resolve the dispute in mediation*. From the above legal provisions, one could conclude that the court does not have this option, if the parties before going to court unsuccessfully attempted to resolve in mediation. For such a legislative solution is no reasonable justification. This, especially, bearing in mind that the same effect produced is that parties to the dispute have not tried to resolve the dispute by peaceful means in mediation before bringing a lawsuit before the court, as well as the fact that they tried unsuccessfully to resolve the dispute in mediation, before bringing a lawsuit before the court. Even if the lawsuit has been filed, does not mean that the parties to the dispute completely closed the door of opportunity for friendly solution of the dispute by mutual agreement in mediation, either at the suggestion of the judge, even if they previously unsuccessfully negotiated in mediation.[31]

3. AGREEMENT ON THE COURT SETTLEMENT AND THE AGREEMENT ON OUT OF COURT SETTLEMENT AND THEIR PROCEDURAL FACTS

The outcome of all forms of mediation (judicial and non-judicial) is always the same - it is a contract on settlement which ends the dispute, and implies that mediation is, indisputably, one of the techniques of alternative dispute resolution. [32]
Agreement on the court settlement is the result of the process of settlement in court between the parties in litigation process in legislations that do not recognize expressly court mediation (like entity legislation of Bosnia and Herzegovina). In all legislations, analyzed in this paper, an agreement on the court settlement has the enforcement power. This is understandable legislative solution, bearing in mind that the parties to the dispute its agreement concluded before the court and with the cooperation of judge. On the other hand, the essence of mediation exactly is that the party to the dispute access to it clearly voluntarily. Concluding contracts on out of court settlement, they agree to voluntarily and in accordance with the rules of *bonae fides* to perform their duties which are imposed to each other in contract. Therefore, it is just the work on the improvement of mechanisms of voluntariness and *bonae fides* fulfillment of obligations arising from contracts on out of court settlement, in order to

[28] art. 186f par. 1. ZPP Hr.
[29] In the same article, the legislator prescribes that if the conciliation before the chosen center for conciliation succeeds, the parties will conclude a court settlement before the court which has sent them for conciliation. (*see* art. 186f. ZPP Hr).
[30] art. 4 par. 2. ZPM BiH (2004).
[31] *To compare* Uzelac, A. (2009), *Komentar Zakona o postupku medijacije u Bosni i Hercegovini,* in *Putevi medijabilnosti u Bosni i Hercegovini*, Sarajevo, p. 27.
[32] Knežević, G. (2012), *Marginalije o pojmovima privatne pravde i ADR-a sa aspekta arbitraže i medijacije,* Zbornik Pravnog fakulteta u Zagrebu, no. 62, p. 433.

increase its compulsory for contracting parties, one of the most demanding requirements that are placed before the legislature in terms of peaceful resolution of disputes.[33]

For example, in some legislations, such as Russian, procedural effects of contract on out of court settlement are not been considered in terms of recognition of its properties of enforceable document. In the Russian law there is no single mechanism of forced direct execution of contracts on out of court settlement. Moreover, the absence of such a mechanism is in line with the basic ideas of mediation, as a form of alternative and out of court settlement. Successfully completed the procedure of out of court settlement of the dispute involves just that the parties resolve the dispute in a manner that fully satisfy their interests. As a result, voluntary performance of the out of court settlement seems, if anything, then the most profitable solution for both sides in the dispute. Eventually refusal of any party to participate in the voluntarily execution of obligations that are grounded in form of treaty on out of court settlement, testified that the aim of mediation have not been achieved.[34] Under these conditions, if any of the parties violates the rights of the other ones, which are based on treaty on out of court settlement, the rights will be restored according to the general rules of civil procedure.[35]

At first glance, it seems absurd associating the treaty on out of court settlement with the need to engagement the state authority, with its apparatus of coercion to participate in its execution. Starting from the fact that the parties to the dispute resolved it by their agreement, it would be natural that those voluntarily implemented that agreement. The logic of that needs lies down in the fact that the solely solution of the dispute by concluding an agreement on out of court settlement in practice, does not guarantee to a creditor of the debtor consistency of its implementation. It is therefore important that a creditor of the dispute in advance can count on the support of the state executive authority in the implementation of the agreement. Bearing in mind that, in the Russian theory is supported the idea of compulsory execution of contracts on out of court settlement. Namely, in this sense, are considered acceptable notary's documents, as a means that is compatible with the nature of the contract on voluntary out of court settlement. Notarial documents is considered in theory as means of facilitating of the direct execution of contracts on out of court settlement, and its promotion as an efficient and the executable means of dispute resolution outside the court.[36] Incorporation of the contract on out of court settlement in the notarial document represents the easiest and fastest way to secure its direct execution. Moreover, this means and does not require any significant legislative interventions.[37]

Despite established opinion that a higher rate of execution of an agreement of the contract on non-judicial mediation rather than court decisions, a study conducted in the US in 2006 by a prof. Coben, shows that the reason of filing a lawsuit before the court in over 1200 cases, is for non-fulfillment of contractual commitments on treaty on non-judicial mediation.[38]

---

[33] Esplugues Mota, C, Marquis, L. (2015), *New Developments in Civil and Commercial Mediation: Global Comparative Perspectives*, Valencia, p. 638.

[34] Solomeina, E.A, *Comments to the art. 12. Comments to The Law on Mediation (clause-by-clause)*, ed. Zaagaynova, S.K, Yarkov, V.V, (2012), p. 142. *stated in* Mota, C. E, Marquis, L, *op. cit.*, p. 639.

[35] art. 12 par. 2. of the Federal law on the procedure for alternative dispute resolution with participation of a mediator (mediation) - Федеральный закон от 27 июля 2010 г. № 193-ФЗ "Об альтернативной процедуре урегулирования споров с участием посредника (процедуре медиации)".

[36] Yarkov, V.V, (2006), *To the Project Law on Mediation//Arbitration court*, Moscow, p. 20, *stated in* Mota, C. E, Marquis, L, *op. cit.*, p. 639.

[37] Kalashnikova, S.I, (2011), *Mediation in the Sphere of Civil Jurisdiction*, Moscow, p. 166-178, *stated in*Mota, C. E, Marquis, L, *op. cit.*, p. 639.

[38] Sussman E. (2008), *Final Step:Issues in Enforcing the Mediation*, u *Contemporary Issues in International Arbitration and Mediation*, The Fordham Papers, p. 344.

One step further Goes provision of Directive 2008/52 / EC of the European Parliament and the Council on certain aspects of mediation in civil and commercial matters, which provides that mediation should not be regarded as a poorer alternative to judicial proceedings in the sense that the implementation of agreements resulting from mediation depended on the good will of the parties.

Member States should therefore ensure parties that the content of their written agreement resulting from mediation to be enforceable.[39] In order to apply the provisions of Directive, Law of Germany on Promoting mediation and other methods of dispute solutions out of court, introduced a direct excitability of agreement obtained by mediation. [40]

The application of the above provision of Directive 2008/52/EC has also resulted in the procedural effects of agreement of out of court settlement in the legislation of Bosnia and Herzegovina, which, according to the explicit legal provision has the direct enforcement power.[41] The legislator does not impose additional conditions of contract, except that it must be in writing and signed by the parties of the mediation procedure, as well as the mediator.[42] The legislator does not impose a requirement of certification of their signatures by a notary public. There is either no requires that the agreement on out of court settlement is equipped by the enforceable clause, respectively a statement of the debtor about the possibility of initiating of enforcement proceedings after the maturity of the creditors' claims. On the procedural effect of the agreement on the out of court settlement also points the provision of the Law on Enforcement Procedure of the Republic of Srpska,[43] according to which, the execution document includes, in addition to listed, also other documents that have been legally designated as an executive document.[44]

Under Serbian law, according to the explicit legal provision, on the issue of effect of the agreement on non-judicial mediation, applicable are the provisions of the Law on Obligations.[45] In this provision, the legislator recognizes to the agreement the substantive effects, which is, after all, undisputed in the legal theory. In order for procedural effects of an agreement on the settlement of the dispute through mediation outside the court, respectively in order agreement to have the direct enforcement power, it should contain an enforceable clause of the debtor, and also to be signed of the parties and the mediator, and certified by the court or a notary public.[46] The effect of the contract on out of court settlement as an executive document arises from the provisions of the Law on Enforcement and Security of Serbia,[47] which stipulates that the executive documents, besides listed ones, have also been designated as such by another law.[48]

In the theory prevailing opinion is that the parties to the dispute, in order to achieve legal certainty and to achieve the enforceability of settlement, in the mediation procedure borrow the form of judicial or arbitral decision.[49] Such a situation exists in the Croatian legislation.

[39] *See also* art. 6. of The Direktive 2008/52/EZ of European Parliament and of The Council on certain aspects of mediation in civil and commercial matters.

[40] §4 Gesetz zur Förderung der Mediation und anderer Verfahren der außergerichtlichen Konfliktbeilegung, BGBl. 2012 I, 1577.

[41] art. 25 ZPM BiH (2004).

[42] art. 24 ZPM BiH (2004).

[43] „Službeni glasnik Republike Srpske“, no. 59/03, 85/03, 64/05, 118/07, 29/10, 57/12, 67/13, *hereinafter referred to as* ZIP RS.

[44] art. 23 par. 1. point 4. ZIP RS.

[45] art. 28 ZP Sr (2014).

[46] art. 27 par. 1. ZP Sr (2014).

[47] „Službeni glasnik Republike Srbije“, no. 106/15, 106/16-authentic interpretation, *hereinafter referred to as* ZIO Sr (2015).

[48] art. 41 par. 1. point 8. ZIO Sr (2015).

[49] Knežević, G. (2012), *Marginalije o pojmovima privatne pravde i ADR-a sa aspekta arbitraže i medijacije,* p. 433.

In comparison with observed legislation, only Croatian legislator explicitly prescribes a conciliation procedure which is carried out *before the court*, by the mediator, of a specific list determined by *the Court President*. Therefore, it is interesting that the Croatian legislator, although recognized the court mediation, explicitly stipulates that the settlement reached in conciliation proceedings conducted in court, has the character of a court settlement.[50] *Ratio* of the attribution to agreement of settlement reached in court mediation procedure the effects of court settlement should be sought in the fact that the mediation process runs the mediator, determined from the list of mediators, determined by the President of the court,[51] respectively judge. On the other hand, when looking at Croatian legislation, it would be interesting to reflect on the effect of the agreement on non-judicial mediation, which is carried out before the mediator of the Mediation Center. The legislator explicitly stipulates that the settlement reached in the conciliation procedure obliges the parties. If the settlement parties assumed certain obligations, they shall be obliged to its timely execution.[52] This provision recognizes the material effect of the contract on out of court settlement, as well as any other obligation law contract. The legislator, in addition, regulates the most important procedural effect of the agreement on the out of court settlement – i.e. the effect of enforceable document. In this sense, he provides that the agreement that was reached in conciliation proceedings is an enforcement document if it found certain obligations on the performance on which the parties can settle, and if it contains a statement payer of direct permission of execution (enforceability clause).[53] From all this, it could be concluded that the legislator recognizes the effect of enforceable document to the contract on out of court settlement. Procedural effect of enforceable document of the contract on out of court settlement is still conditioned by its form. Namely, provides that the parties *may* agree that the settlement bands in the form of a notarial deed, a court settlement, or an arbitration award based on settlement.[54] The potential *ability* of the parties to contract the out of court settlement in some of the offered "justice" form - a notary, court or arbitration, could not be interpreted only as a possibility, having on mind this provision. For the correct interpretation, and for the correct understanding of the procedural executive effects of the contract on out of court settlement in the Croatian legislation, should been taken into account the provisions of the Act of Civil Procedure Croatian, which, on the imperative manner, provides that if the litigants, which are forwarded to mediation by the judge, conclude an out of court settlement in mediation procedure before elected conciliation center, *will also* conclude the court settlement.[55] Litigants, upon completion of resolving their dispute in the non-judicial mediation, however, do not have a choice whether or not their agreement on out of court settlement conclude in one of the available forms, because the legislator regulated as their duty to formulate their contract in one of the available forms in order to give the procedural effects of enforceable document to the contract. The only option that is at their disposal is to choose whether their agreement on out of court mediation would be concluded in the form of a notarial deed, a court settlement, or an arbitration award on the basis of a settlement. Respecting to the end of the letter of the law, this conclusion arises only if the agreement on out of court settlement is concluded during civil proceedings, or if the litigants were instructed by the trial court on the process of mediation. If they initiate the mediation procedure on their own initiative, before the civil

[50] art. 186d par. 1. and 4. ZPP Hr.
[51] art. 186d par. 3. ZPP Hr.
[52] art. 13 par. 1. ZM Hr.
[53] art. 13 par. 2. ZM Hr. The debtor, by the enforceability clause expressly agrees to the settlement can be conducted directly forced execution in order to realize the required performance after the maturity of the obligation. Enforcement clause may be contained even in a separate document. (art. 13 par. 3. ZM Hr).
[54] art. 13 par. 5. ZM Hr.
[55] art. 186f par. 3. ZPP Hr.

proceedings initiated, than the agreement on the settlement reached in mediation out of court has the procedural effects of enforceable document under the terms provided under the provision of art. 13ZM Hr. In this case derived conclusion from above couldn't be able to apply, and the parties would have an opportunity to decide whether or not their settlement to give the form of a notarial deed, a court settlement, or an arbitration award on the basis of a settlement, as it clearly provides legislator.[56]

In light of the two dilemmas, set in the paper, or in terms of the possibility of participation of judge as mediator between the litigants in the course of the litigation, it was concluded that the entity law of Bosnia and Herzegovina, does not provide the judge to conduct the mediation procedure, but he's only enabled to refer to litigants the possibility of mediable solution of their dispute with the participation of mediators, which they amicably elected from the list of mediators kept by the Association of mediators of Bosnia and Herzegovina. In this sense, as the legislator makes a clear distinction between mediators, conducting the proceedings of out of court mediation, and judges who take part in the conclusion of the settlement before the court, it is clear that the parties, with the cooperation of judges can only conclude a court settlement with the effect of enforceable document. On the other hand, sides may conclude an agreement on out of court settlement with cooperation of mediators in the mediation procedure, with the procedural effect of enforceable document, unconditioned with certify the signatures of the parties by a notary public or clause by which the debtor agrees to immediately enforce performance under the contract, after the maturity of receivables.

When it comes to the law of Serbia, although with certain peculiarities, the situation would be similar to the law of Bosnia and Herzegovina. The fact that the parties to the dispute may, during the civil proceedings engage the judge to conduct the mediation procedure, does not bring to conclusion that in this case was a judicial mediation, bearing in mind that the legislator restricted judge by states that his work as mediator could be performed *only* after working hours without compensation. In this case, the agreement concluded with the cooperation of judge, in a procedure that he carried out under these conditions, would have the effect of an agreement concluded in the non-judicial mediation, with the procedural effect of enforceable document, under the conditions as prescribed by law, and previously discussed in this paper.

4. CONCLUSION

By agreement on extrajudicial settlement faces, between which there is a dispute or uncertainty of a legal relationship, by mutual indulgence interrupt slow or eliminate uncertainty and determine their mutual rights and obligations.[57] It follows that the agreement on out of court settlement, primarily, by its legal nature is a classic contract of contract law. It regulates completely or partially settle of mutual obligations between the parties in the civil or commercial law dispute. How obligation law contracts, by their legal nature, do not have procedural, but only substantive effects, agreement on out of court settlement concluded in mediation procedure, although the primary contract of substantive law, confirms the *sui generis* specifics, just by its procedural effects. This shows that the legal security of the parties in the mediation procedure requires voluntariness at the conclusion of the contract on out of court settlement to be derogated by forced enforceability of such a contract. This due to the fact that there is no perfect mechanism, which would allow a creditor to be, after the concluded contract on out of court settlement in mediation procedure, safely relied on its execution, outside the state's apparatus of coercion. This attitude, with certain nuances, today supports legislation of observed countries in the Region. To single out only the Croatian

[56] art. 13 par. 5. ZM Hr.
[57] art. 1089 of Law on Obligations („Službeni glasnik Republike Srpske", no. 17/93, 3/96).

legislation, which does recognize the direct effect of enforceable document to the contract on settlement in mediation out of court, only if such agreement is incorporated in the decision of the court, the arbitral tribunal, or if it is concluded in public notarial form.
Classic executive procedure does not guarantee speed, neither economy to the creditor in forced execution of the contract out of court settlement. Nevertheless, today, not only in the Region, but also in a broader sense, assigning a direct procedural effects of enforceable document to the contract of extrajudicial settlement is the only way to secure a creditor under this agreement to come to its execution in a forced way with the participation of the state, if the debtor voluntarily fails to perform his obligations.

ACKNOWLEDGEMENT: *Gratitude to colleague Dejan Pilipovic, M.A., on his well meaning suggestions, given when creating this paper.*

LITERATURE:

1. Uzelac, A. (2009), *Komentar Zakona o postupku medijacije u Bosni i Hercegovini,* in *Putevi medijabilnosti u Bosni i Hercegovini,* Sarajevo.
2. Esplugues Mota, C, Marquis, L. (2015), *New Developments in Civil and Commercial Mediation: Global Comparative Perspectives,* Valencia.
3. Bühring-Uhle C., Kirchhoff, L., Scherer, G. (2006), *Arbitration and Mediation in International Business,* Kluwer Law International.
4. Sussman, E. (2008), *Final Step:Issues in Enforcing the Mediation,* u *Contemporary Issues in International Arbitration and Mediation,* The Fordham Papers.
5. Knežević, G. (2012), *Marginalije o pojmovima privatne pravde i ADR-a sa aspekta arbitraže i medijacije,* Zbornik Pravnog fakulteta u Zagrebu, no. 62.
6. Knežević, G. (2006), *Pravo i promene: ADR – promena u pravu,* Annals of the Faculy of Law, Belgrade, no. 2.
7. Kalashnikova, S.I. (2011), *Mediation in the Sphere of Civil Jurisdiction,* Moscow.
8. Karamarković, L. (1996), *Sudsko i vansudsko poravnanje,* Pravni život, Belgrade, no. 12.
9. Solomeina, E.A. (2012), *Comments to the art. 12. Comments to The Law on Mediation (clause-by-clause),* ed. Zaagaynova, S.K., Yarkov, V.V., Moscow.
10. Yarkov, V.V. (2006), *To the Project Law on Mediation//Arbitration court,* Moscow.
11. Marković, V. (2015), *Ugovor o poravnanju,* Proceedings to the International Scientific Conference on IT and Business-related Research, Synthesis, Belgrade.

ALTERNATIVE DISPUTE RESOLUTION IN MEDICAL MALPRACTICE DISPUTES

Petr Sustek
Centre for Medical Law and Department of Civil Law, Faculty of Law, Charles University
Prague, Czech Republic
sustek@prf.cuni.cz

Tomas Holcapek
Department of Civil Law, Faculty of Law, Charles University
Prague, Czech Republic
holcapek@prf.cuni.cz

ABSTRACT

Alternative dispute resolution (ADR) is a category comprising various techniques which enable the parties to resolve their conflicts out of the highly formalized judicial proceedings. In many legal systems, ADR is an increasingly popular set of legal instruments to resolve disputes because of its cost-effectiveness and time-effectiveness, flexibility, confidentiality and respect for unique aspects of a particular case. While it is traditionally associated primarily with commercial arbitration on one hand and consumer disputes on the other hand, ADR has been introduced also to the area of medical malpractice disputes. With the growing numbers of these disputes as well as rising amounts of compensation in many Western countries, the use of ADR in health care context is only logical and its further increase can be expected. Many studies show not only that ADR methods such as early apology, mediation or arbitration are very rational from an economic perspective for the health care providers, but also that these techniques improve the patients', or their relatives', satisfaction. However, very serious questions may arise about the suitability and even legality of the use of ADR in medical malpractice cases given mainly its possible interference with the human right to access to justice. The paper first introduces the ADR, its particular techniques and their use in medical malpractice disputes. Benefits and disadvantages of ADR in medical malpractice disputes are then analysed with a special emphasis on its possible conflict with the human, and constitutionally protected, right to access to justice.

The paper eventually assesses the conditions of suitability of ADR in the specific context of medical malpractice disputes.

Keywords: *alternative dispute resolution, health law, medical malpractice, medical malpractice litigation, health care*

1. INTRODUCTION

Alternative dispute resolution (hereinafter "ADR") is a modern approach to cost-effective dispute resolution which has been gradually spreading from its traditional realm in commercial law to other private law areas. Many of its traits, including confidentiality and emphasis on mutually acceptable solutions, seem to be suitable for medical negligence disputes. The paper will first define the term ADR and introduce some of the most frequently used ADR techniques. In the second chapter, the paper will focus on the most important benefits and disadvantages of ADR. The authors will then assess the suitability of ADR in medical malpractice disputes. Before we will start to explore the topic of this paper, we should note that medical negligence is not the only possible cause of dispute in the health care area. Heath care systems are based on the triangle of relationships: the relationship between the patient and the provider of health care, the relationship between the provider of health care and the health insurance company, and the relationship between the health

insurance company and the patient/insured person.[1] In all these relationships, disputes may arise which could be resolved through ADR. However, the paper focuses primarily on the relationship between the patient and the health care provider and therefore on the question of ADR in medical malpractice disputes.

2. ALTERNATIVE DISPUTE RESOLUTION (ADR)

ADR represents a wide variety of techniques aiming at finding solutions to the disputes between parties without costly and long court procedure. The term ADR has no consensually agreed definition. However, there may be identified several features which interconnect all ADR techniques and may serve as a kind of complex definition of the concept. We may consider following components of the ADR definition: 1) the existence of dispute between two or more parties 2) related to civil legal rights and/or duties, 3) which might be resolved in litigation before the court, 4) but, based on the choice of parties, is resolved through a different process 5) which is essentially confidential and 6) involves independent individuals who bring a certain level of objectivity to the process.[2]

ADR techniques are diverse and many, varying among different jurisdictions.[3] They generally include negotiation, mediation, conciliation, or arbitration, but also complaints and grievance procedures, ombudsman procedures, dispute-resolution board procedures, expert intervention and others.[4] In the USA, pretrial screening panels are a popular mean to determine the chances of the parties in litigation in medical malpractice cases.[5] In this paper, we will focus on several of the most frequently used techniques which seem to be suitable for the use in medical malpractice cases, i.e. negotiation and early apology, mediation, and arbitration.

2.1. Negotiation and early apology

Negotiation is the most informal of all ADR techniques.[6,7] Its process is very simple and natural: it is any form of communication, direct or indirect, between the parties with opposing interests (usually accompanied by their lawyers) carried out in order to resolve their dispute.[8] For most of people, health is one of the crucial values, and a serious damage to their own or their beloved ones' health is justly perceived as a personal tragedy. In a situation of shock and grief, many patients or their relatives are motivated primarily by the desire for truth, justice, and the safety of other patients rather than high financial damages.[9]

[1] See

[2] See ibid., p. 6.

[3] PETROV KŘIVÁČKOVÁ, J. (2015). Rozhodčí řízení. In R. ŠÍNOVÁ, J. PETROV KŘIVÁČKOVÁ, Jana (ed.), *Civilní proces. Řízení nesporné, rozhodčí a s mezinárodním prvkem* (p. 245). Praha: C. H. Beck, 2015.

[4] See SIME, S., BLAKE, S., BROWNE, J. (2011). *A Practical Approach to Alternative Dispute Resolution* (p. VI). New York: Oxford University Press. See also SMOLÍK, P. (2014). Alternativní řešení sporů. In A. WINTEROVÁ, A. MACKOVÁ (ed.), *Civilní právo procesní. První část – Řízení nalézací* (7th edition) (p. 564-565). Praha: Linde.

[5] See SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.

[6] Ibid.

[7] Some authors exclude negotiation from ADR techniques for its lack of involvement of a third party. However, we find such a strict approach needlessly narrow. See SIME, S., BLAKE, S., BROWNE, J. (2011). *A Practical Approach to Alternative Dispute Resolution* (p. 5). New York: Oxford University Press.

[8] Government of Canada, Department of Justice. (2015). *Dispute Resolution Reference Guide.* Retrieved 17 May 2017 from http://www.justice.gc.ca/eng/rp-pr/csj-sjc/dprs-sprd/res/drrg-mrrc/03.html.

[9] See KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví* (p. 13, 51-52). Olomouc: Iuridicum Olomoucense.

For this reason, negotiation can be reasonably accompanied by programs designed to facilitate early disclosure and apology.[10] We will discuss the role of early apology in ADR below.

2.2. Mediation

Mediation, simply put, is a negotiation facilitated by one or more neutral third-party mediators chosen by the parties.[11] Even though it is more complex than negotiation, mediation is still very informal procedure in which the parties often participate without their lawyers saving both time and costs. The informality of mediation also means that the parties may agree on creatively chosen form of compensation even in cases where the litigation could only lead to monetary compensation. Very important is a non-binding nature of mediation which can be anytime left by any party.[12] Mediators act to help the parties to reach an agreement and cannot sanction them or force them to resolve their dispute.[13]

Given the personal nature of doctor-patient relationship, mediation seems to be a natural mean to resolve medical malpractice disputes where the parties are not able to reach a consensus on their own.[14] There may be identified several different mediation practices which can be combined in order to find the most suitable method for a particular situation.[15] Probably most important of them are facilitative mediation, evaluative mediation, and transformative mediation.[16]

2.3. Arbitration

By far the most formal ADR technique is arbitration. An arbiter or arbitration panel hears the argumentation of the parties typically represented by lawyers and then issues a binding decision.[17] The system of judicial review of arbitration awards differ among jurisdictions.[18] The arbitrability of dispute may be based on a pre-treatment arbitration clause in a contract between physician and patient, or on an arbitration agreement signed when the dispute had already arisen.[19]

Arbitrations can be differentiated to ad hoc and institutional arbitrations. Probably the greatest benefit of institutional arbitration is the reputation and authority of the institution for which the counterparty is more likely to voluntarily fulfil the arbitration award.

---

[10] See SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.

[11] See ibid. See also KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví* (p. 26). Olomouc: Iuridicum Olomoucense.

[12] See SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.

[13] KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví* (p. 26). Olomouc: Iuridicum Olomoucense.

[14] See CURRIE, C. M. Mediation and Medical Malpractice Disputes. *Mediation Quarterly*, 2007 (Vol. 15, No. 3), p. 215.

[15] KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví* (p. 28). Olomouc: Iuridicum Olomoucense.

[16] See a review of these basic mediation styles in ZUMETA, Z. Styles of Mediation: Facilitative, Evaluative, and Transformative Mediation. *Mediate.com.* Retrieved 17 May 2017 from http://www.mediate.com/articles/zumeta.cfm.

[17] See SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.

[18] SMOLÍK, P. (2014). Alternativní řešení sporů. In A. WINTEROVÁ, A. MACKOVÁ (ed.), *Civilní právo procesní. První část – Řízení nalézací* (7th edition) (p. 572). Praha: Linde.

[19] See KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví* (p. 43-44). Olomouc: Iuridicum Olomoucense.

The institutional arbitration is more similar to litigation than any other ADR technique, given its formal nature and a little control of parties over the process.[20]
Here, we can briefly present a situation in the Czech Republic. Around the year 2008, there culminated preparatory work on the project of permanent arbitration court for disputes in health care which should have been located in the town of Kladno near Prague. The planned institution was meant to resolve the disputes between patients, health care providers and health insurance companies regarding reimbursement of health care. The plans were, however, not realized. It needs to be noted that according to some experts, arbitration in matters of reimbursement of health care would violate Czech constitution, since disputes related to the constitutional right to health care must not be excluded from judicial review.

3. THE BENEFITS AND DISADVANTAGES OF ADR IN MEDICAL MALPRACTICE DIPUTES

There may be identified many potential benefits and disadvantages of ADR both in general and in the specific context of medical malpractice disputes. ADR techniques may, in general, provide the parties with confidentiality,[21] more control over the process and outcome of dispute resolution, and a place for more creativity in choosing the form of compensation. Regarding medical malpractice disputes, it might be appreciated that ADR allows an expert in particular medical field to guide the parties through the process and, in some cases, to decide the matter.[22,23] Similarly, there can be identified many potential disadvantages of the use of ADR. In this chapter, we will focus on one main benefit and one disadvantage that could be arguably connected to ADR in medical malpractice disputes: i.e. its cost-effectiveness on one hand and a potential conflict with human rights on the other hand.

3.1. Cost-effectiveness

It can be assumed that the most important incentive for the parties to use ADR in any kind of dispute is its cost-effectiveness compared to litigation. The most obvious costs of dispute resolution are money and time. Many studies satisfactorily prove that ADR effectively saves both of these values.[24] According to the European Parliament study from 2014, average number of days in litigation in EU countries was 566, while mediation took in average only

[20] See SMOLÍK, P. (2014). Alternativní řešení sporů. In A. WINTEROVÁ, A. MACKOVÁ (ed.), *Civilní právo procesní. První část – Řízení nalézací* (7th edition) (p. 568). Praha: Linde.
[21] The confidentiality of ADR may be very attractive not only to health care providers who need to preserve their reputation, but in some cases also to patients and their families who wish not to lose their privacy especially in very sensitive matters of health and illness. See LEE, D. W. H., LAI, P. B. S. The practice of mediation to resolve clinical, bioethical, and medical malpractice disputes. *Hong Kong Medical Journal*, 2015 (Vol. 21, No. 6), p. 561.
[22] See SIME, S., BLAKE, S., BROWNE, J. (2011). *A Practical Approach to Alternative Dispute Resolution* (p. 6-7). New York: Oxford University Press.
[23] The problem of lack of medical expertise of decision-makers is often discussed in USA where factual questions in disputes are decided by the jury. However, the lack of medical knowledge is a problem also in jurisdictions where a professional judge decides both factual and legal questions of the case. A very important role of an expert witness who is completely strange to parties and their unique history can lead to parties' stress and perceived dehumanization of the process.
[24] See for example a review of several ADR techniques used in medical malpractice disputes in the USA in BALCERZAK, G. A., LEONHARDT, K. K. (2008). Alternative Dispute Resolution in Healthcare. A Prescription for Increasing Disclosure and Improving Patient Safety. *Patient Safety & Quality Healthcare.* Retrieved 18 May 2017 from https://www.psqh.com/julaug08/resolution.html. See also a review of studies evaluating the effectiveness of arbitration and mediation in general context in Metropolitan Corporate Counsel. *Cost-Effective, Fast And Fair: What The Empirical Data Indicate About ADR.* Retrieved 18 May 2017 from http://www.metrocorpcounsel.com/articles/4732/cost-effective-fast-and-fair-what-empirical-data-indicate-about-adr.

43 days. While this enormous disproportion was partly influenced by exceedingly long litigations in Greece, Slovenia, and Italy (where the average litigation took over 1000 days), in all Member States the litigation was many times more time-consuming than mediation (the shortest average time of litigation – 300 days - was in Lithuania, where mediation took in average 30 days).[25] Similarly, the average cost of litigation in EU countries was 9.179 €, while mediation costed in average 3.371 €. Mediation was, in average, more costly than litigation only in Estonia, Poland, and Portugal; in all other EU countries the mediation represented a cost-saving alternative.[26] In terms of monetary and time costs, therefore, ADR is undoubtedly a significantly effective method of dispute resolution.

However, even more interesting – and perhaps also more important – are other positive aspects of ADR. In a cost-effectiveness calculus, we should include also different kinds of costs, which cannot be expressed in exact numbers, but which are of a great importance for the parties. These costs reflect perceived satisfaction of each party.[27] If we face the data, we find that ADR is really increasing the parties' satisfaction in a significant manner. The party satisfaction rates are highest in mediation: in the context of medical negligence disputes, the party satisfaction with mediation is reported to be 90 % among both plaintiffs and defendants.[28] The success rate of mediation in avoiding litigation is reported to be 75 to 90 %. While arbitration is less satisfying than mediation, it still has better outcomes in this respect compared to litigation.[29]

Another important advantage of ADR is its suitability for preserving the physician-patient relationship. This can be understood also in terms of saving sometimes significant emotional as well as financial and time costs connected with breaking up a long-term cooperation and finding a new physician.

Unlike litigation, the mediation aims at improving communication and mutual understanding between the parties, psychological closure of adverse events, preservation of physician-patient relationship etc. These therapeutic aims of mediation therefore seem to be in accordance with the primary aim of medicine: healing.[30]

---

[25] DE PALO, G., D'URSO, L., TREVOR, M., BRANON, B., CANESSA, R., CAWYER, B., REAGAN FLORENCE, L. (2014). *'Rebooting' the Mediation Directive: Assessing the Limited Impact of its Implementation and Proposing Measures to Increase the Number of Mediations in the EU* (p. 124). Directorate General for Internal Policies, Policy Department C: Citizens' Rights and Constitutional Affairs.

[26] Ibid., p 126.

[27] We realize that the question of party satisfaction is quite complex and belongs rather to the field of psychology. However, we do not intend nor have a possibility to study satisfaction in detail in this paper; we simply use the term as an indicator of party's positive perception of the used method of dispute resolution and its outcome. For a more detailed study of party satisfaction, see for example the work of Levin and Guthrie, who identify three main types of factors influencing satisfaction (party expectations, process factors, and outcome factors) and stress the need to work with these factors in order to further increase the satisfaction rates. LEVIN, J., GUTHRIE, C. A "Party Satisfaction" Perspective on a Comprehensive Mediation Statute. *Ohio State Journal on Dispute Resolution*, 1998 (Vol. 13, No. 3), p. 885-907.

[28] SZMANIA, S. J., JOHNSON, A. M., MULLIGAN, M. Alternative Dispute Resolution in Medical Malpractice: A Survey of Emerging Trends and Practices. *Conflict Resolution Quarterly*, 2008 (Vol. 26, No. 1), p. 81. SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378. According to some different studies, party satisfaction rates of mediation vary between 60 and 90 %. In any case, these rates are much higher in mediation than in litigation. See BULLOCK, S. G., GALLAGHER, L. R. Surveying the State of the Mediative Art: A Guide to Institutionalizing Mediation in Louisiana. *Louisiana Law Review*, 1997 (Vol. 57, No. 3), p. 921-922.

[29] SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.

[30] GALTON, E. Mediation of Medical Negligence Claim. *Capitol University Law Review*, 2000 (No. 2), p. 321.

On a broader scale, the more frequent use of ADR can moderate the trend of growing number of medical malpractice litigations and rising amounts of compensation which lead to the so called defensive medicine, i.e. the practice of medicine influenced by the fear of litigation. Too defensive practice of medicine results not only in increased health care costs due to unnecessary diagnostic tests and procedures, but also in the increase of health risks to the patients through, among other factors, the provision of unnecessary invasive procedures and avoiding necessary but risky procedures and patients with complications.[31]

The benefits of ADR can be explained with the help of studies focused on psychology of patients (or their relatives) and physicians in medical malpractice disputes. The most important motivation of plaintiffs is usually not only a financial compensation, but rather a timely and truthful explanation of situation, early apology and expression of compassion, adoption of preventive measures in order to avert the same mistake in future, and the possibility of psychological closure of the case.[32] On the other hand, physicians usually perceive medical malpractice litigation as an extreme form of criticism which may endanger their reputation and financial stability, exposes emotional vulnerabilities[33] and, as several studies show, may even lead to serious psychological and psychiatric problems including depression.[34] These feelings lead physician to a defensive approach in which they are not inclined to admit their own mistakes or to engage in an honest communication with the victim.[35] In the end, litigation often leaves both parties feeling misunderstood, disrespected and hurt. This is only aggravated by costly, time-consuming, and depersonalized process, which leaves the victim for many years in uncertainty about what happened and without the possibility to reach a psychological closure of adverse events.[36] The physician, similarly, is left for many years in uncertainty regarding her or his professional future.

A very important role in preventing and resolving disputes has early disclosure and apology. Since patients have rarely medical expertise necessary for determining a medical quality of provided health care, they evaluate the care on the basis of physician's efforts, the quality of physician-patient relationship, and the degree to which the physician fulfils their expectations.[37] A breakdown in physician-patient relationship, most often consisting in unsatisfactory communication,[38] has been shown to be one of the most important (if not the most important) incentives for the patients to sue their physicians for malpractice. On the other hand, patients are not likely to sue physicians with whom they have a trusting and mutually respecting relationship.[39] The physician-patient personal relationship was therefore found to be a major determinant of whether the patient will bring the malpractice case to

[31] See SEKHAR, M. S., VYAS, N. Defensive Medicine: A Bane to Healthcare. *Annals of Medical and Health Sciences Research,* 2013 (Vol. 3, No. 2), p. 295-296.
[32] KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví* (p. 13, 51-52). Olomouc: Iuridicum Olomoucense.
[33] McMULLEN, A. Mediation and Medical Malpractice Disputes: Potential Obstacles in the Traditional Lawyer's Perspective. *Journal of Dispute Resolution,* 1990 (No. 2), p. 377-378.
[34] MORREIM, H. Malpractice, Mediation, and Moral Hazard: The Virtues of Dodging the Data Bank. *Ohio State Journal on Dispute Resolution,* 2012 (Vol. 27, No. 1), p. 115.
[35] See MERUELO, N. C. Mediation and Medical Malpractice: the Need to Understand Why Patients Sue and a Proposal for a Specific Model of Mediation. *Journal of Legal Medicine,* 2008 (Vol. 29, No. 3), p. 289.
[36] See DAUER, E. A., MARCUS, L. J., PAYNE, S. M. C. Prometheus and the Litigators: A Mediation Odyssey. *The Journal of Legal Medicine,* 2000 (Vol. 21, No. 2), p. 161.
[37] KELLETT, A. J. Healing Angry Wounds: The Roles of Apology and Mediation in Disputes between Physicians and Patients. *Journal of Dispute Resolution,* 1987, p. 123.
[38] See HUNTINGTON, B., KUHN, N. Communication Gaffes: A Root Cause of Malpractice Claims. *Baylor University Medical Center Proceedings,* 2003 (Vol. 16, No. 2), p. 157.
[39] Ibid., p. 157.

litigation. An early, honest, and respectful disclosure and apology reduced the physician's risk of being sued:[40] it was reported to have 50 to 67 % success in avoiding litigation.[41]
Negotiation, which may follow early apology, lead to resolutions with greater durability than agreements reached by other ADR techniques.[42]
For this reason, health care providers should, as a part of the risk management, reasonably support a prompt identification of negligently inflicted harm of patients, disclosure and apology. Such approach can be considered a special ADR strategy which would result in early resolution of many otherwise costly disputes.[43] The experience shows that a proactive policy of full disclosure, even when patients have no suspicion of negligence, applied along with implementing preventive measures, significantly decreases the health care provider's costs of medical negligence disputes.[44] The fear of litigation, however, makes physicians and health care providers do the right opposite: admit nothing and evade contact with the victim.

3.2. Possible conflict with the right to access to justice

The right to access to justice (as proclaimed, for example, in Article 10 of the Universal Declaration of Human Rights or Article 6 of the European Convention of Human Rights) undoubtedly represents one of fundamental human rights. In certain sense, it is a very basic human right, since it is a condition for the realization of other rights. The right to access to the courts is a necessary condition for any realization of the right to a fair trial.[45]
According to the European Court for Human Rights, the right to justice has a prominent place in a democratic society and therefore must be interpreted in a broad manner.[46] While the use of ADR effectively evades excessive length of proceedings which is statistically the most frequently invoked violation of Article 6 of the European Convention of Human Rights,[47] it does not guarantee the standards provided by formalised court procedure. The plaintiffs may not (and probably would not) be awarded full compensation for which they would have right in litigation. Furthermore, settlements are often based on compromising opposite interests rather than reflecting the most accurate picture of events and even arbitrators are likely to compromise.[48] For a party which is sure about her or his version of events, ADR may not seem satisfactory.

---

[40] KELLETT, A. J. Healing Angry Wounds: The Roles of Apology and Mediation in Disputes between Physicians and Patients. *Journal of Dispute Resolution*, 1987, p. 123-124.
[41] SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.
[42] FRASER J. J., the Committee on Medical Liability. Technical Report: Alternative Dispute Resolution in Medical Malpractice. *Pediatrics*, 2001 (Vol. 107, No.3), p. 603.
[43] See METZLOFF, T. B. Alternative Dispute Resolution Strategies in Medical Malpractice. *Alaska Law Review*, 1992 (Vol. 9, No. 2), p. 438.
[44] Such policy was implemented in the Veterans Affairs Medical Center in Lexington, USA, in 1987. Between 1987 and 2003, 170 settlements were negotiated in the hospital, from which only three resulted in litigation. The average payout was 16 000 USD, compared to the median amount of monetary compensation awarded by courts in medical negligence cases in 1994 and 1995 which made 463 000 USD, with an additional $250,000 in associated costs of lawsuit preparation and litigation. BALCERZAK, G. A., LEONHARDT, K. K. (2008). Alternative Dispute Resolution in Healthcare. A Prescription for Increasing Disclosure and Improving Patient Safety. *Patient Safety & Quality Healthcare.* Retrieved 18 May 2017 from https://www.psqh.com/julaug08/resolution.html.
[45] See MOLEK, P. (2012). *Právo na spravedlivý proces* (p. 74). Praha: Wolters Kluwer.
[46] See *Delcourt v. Belgium*, European Court of Human Rights judgment of 17 January 1970, Application no. 2689/65, § 25.
[47] WADE, Gordon. (2010). Mediation: Article 6, Mandatory Mediation and the Hallmark of Democracy. *CPD Seminars*. Retrieved 19 May 2017 from https://www.cpdseminars.ie/articles/mandatory-mediation-and-the-hallmark-of-democracy/#_ftn17.
[48] See SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.

These issues do not constitute any problem if the use of ADR is voluntary. However, in case of mandatory ADR, these reasons could easily justify the allegations of violation of the right to justice. There are disputes whether mandatory ADR would have satisfactory outcomes and whether it does not contradict the very nature of ADR consisting in voluntariness. Proponents of mandatory ADR argue that it does not represent an obstacle to access to trial but at most a temporary suspension of it.[49] The European Court of Human Rights have not yet issued any decision on the matter and its position would probably depend on a number of factors such as the binding or non-binding character of used ADR technique, the length of ADR procedure, the requirement to pay fees, or the possibility of subsequent litigation.[50] For comparison, obligatory mediation in medical malpractice disputes is considered unconstitutional in the USA for it allegedly prevents victims from access to the courts.[51]

4. CONCLUSION

It can be concluded that all selected ADR techniques, i.e. negotiation with early disclosure and apology, mediation, and arbitration, are highly effective in avoiding litigation and saving monetary, time, and emotional (and even health) costs of the parties. However, we would not recommend mandatory use of ADR in medical negligence disputes. At least until the case-law of international courts, in European area primarily the European Court of Human Rights, and the legal literature decide on the question of possible violation of the right to justice, mandatory ADR should not be applied. However, it is highly advisable to encourage the use of ADR, even though the line between encouragement and coercion may be blur.

There are many ways to increase the use of ADR. Permanent specialized arbitration courts for medical negligence disputes may be established. However, it seems to be most effective to support the implementation of early disclosure and apology programs with subsequent negotiation and/or mediation. It is vital to ensure that strict confidentiality of negotiation and mediation will be respected and that the apology will not be used against the defendant in a potential subsequent litigation. For this reason, we find is very important to enact so-called apology laws which render physician's apology inadmissible in court[52] and therefore removes one of the heaviest obstacles to a good physician-patient communication. In this way, the honest communication may be encouraged and cost-effective ways of resolving disputes may finally become more common in practice.

LITERATURE:

1. BALCERZAK, G. A., LEONHARDT, K. K. (2008). Alternative Dispute Resolution in Healthcare. A Prescription for Increasing Disclosure and Improving Patient Safety. *Patient Safety & Quality Healthcare.* Retrieved 18 May 2017 from https://www.psqh.com/julaug08/resolution.html.
2. BULLOCK, S. G., GALLAGHER, L. R. Surveying the State of the Mediative Art: A Guide to Institutionalizing Mediation in Louisiana. *Louisiana Law Review,* 1997 (Vol. 57, No. 3).

[49] See WADE, Gordon. (2010). Mediation: Article 6, Mandatory Mediation and the Hallmark of Democracy. *CPD Seminars.* Retrieved 19 May 2017 from https://www.cpdseminars.ie/articles/mandatory-mediation-and-the-hallmark-of-democracy/#_ftn17.

[50] See McGREGOR, Lorna. Alternative Dispute Resolution and Human Rights: Developing a Rights-Based Approach through the ECHR. *The European Journal of International Law,* 2015 (Vol. 26, No. 3), p. 622-634.

[51] KULMS, R. (2013). Mediation in the USA: Alternative Dispute Resolution between Legalism and Self-Determination. In K. J. HOPT, F. STEFFEK, Felix (eds.), *Mediation: Principles and Regulation in Comparative Perspective* (p. 1257). Oxford: Oxford University Press.

[52] See HO, B., LIU, E. Does Sorry Work? The Impact of Apology Laws on Medical Malpractice. *Journal of Risk and Uncertainty,* 2011 (Vol. 43, No. 2), p. 141-167.

3. CURRIE, C. M. Mediation and Medical Malpractice Disputes. *Mediation Quarterly,* 2007 (Vol. 15, No. 3).
4. DAUER, E. A., MARCUS, L. J., PAYNE, S. M. C. Prometheus and the Litigators: A Mediation Odyssey. *The Journal of Legal Medicine,* 2000 (Vol. 21, No. 2).
5. *Delcourt v. Belgium*, European Court of Human Rights judgment of 17 January 1970, Application no. 2689/65.
6. DE PALO, G., D'URSO, L., TREVOR, M., BRANON, B., CANESSA, R., CAWYER, B., REAGAN FLORENCE, L. (2014). *'Rebooting' the Mediation Directive: Assessing the Limited Impact of its Implementation and Proposing Measures to Increase the Number of Mediations in the EU* (p. 124). Directorate General for Internal Policies, Policy Department C: Citizens' Rights and Constitutional Affairs.
7. European Convention on Human Rights. (1950). *Convention for the Protection of Human Rights and Fundamental Freedoms.*
8. FRASER J. J., the Committee on Medical Liability. Technical Report: Alternative Dispute Resolution in Medical Malpractice. *Pediatrics*, 2001 (Vol. 107, No.3), p. 602-607.
9. GALTON, E. Mediation of Medical Negligence Claim. *Capitol University Law Review*, 2000 (No. 2).
10. Government of Canada, Department of Justice. (2015). *Dispute Resolution Reference Guide.* Retrieved 17 May 2017 from http://www.justice.gc.ca/eng/rp-pr/csj-sjc/dprs-sprd/res/drrg-mrrc/03.html.
11. HO, B., LIU, E. Does Sorry Work? The Impact of Apology Laws on Medical Malpractice. *Journal of Risk and Uncertainty*, 2011 (Vol. 43, No. 2), p. 141-167.
12. HUNTINGTON, B., KUHN, N. Communication Gaffes: A Root Cause of Malpractice Claims. *Baylor University Medical Center Proceedings,* 2003 (Vol. 16, No. 2).
13. KELLETT, A. J. Healing Angry Wounds: The Roles of Apology and Mediation in Disputes between Physicians and Patients. *Journal of Dispute Resolution,* 1987.
14. KOTULA, J., DOLEŽAL, T. (2015). *Mediace a další vybrané formy mimosoudního řešení sporů ve zdravotnictví.* Olomouc: Iuridicum Olomoucense.
15. KULMS, R. (2013). Mediation in the USA: Alternative Dispute Resolution between Legalism and Self-Determination. In K. J. HOPT, F. STEFFEK, Felix (eds.), *Mediation: Principles and Regulation in Comparative Perspective* (p. 1245-1328). Oxford: Oxford University Press.
16. LEE, D. W. H., LAI, P. B. S. The practice of mediation to resolve clinical, bioethical, and medical malpractice disputes. *Hong Kong Medical Journal,* 2015 (Vol. 21, No. 6).
17. LEVIN, J., GUTHRIE, C. A "Party Satisfaction" Perspective on a Comprehensive Mediation Statute. *Ohio State Journal on Dispute Resolution,* 1998 (Vol. 13, No. 3), p. 885-907.
18. McGREGOR, Lorna. Alternative Dispute Resolution and Human Rights: Developing a Rights-Based Approach through the ECHR. *The European Journal of International Law,* 2015 (Vol. 26, No. 3), p. 607-634.
19. McMULLEN, A. Mediation and Medical Malpractice Disputes: Potential Obstacles in the Traditional Lawyer's Perspective. *Journal of Dispute Resolution,* 1990 (No. 2).
20. MERUELO, N. C. Mediation and Medical Malpractice: the Need to Understand Why Patients Sue and a Proposal for a Specific Model of Mediation. *Journal of Legal Medicine,* 2008 (Vol. 29, No. 3).
21. Metropolitan Corporate Counsel. *Cost-Effective, Fast And Fair: What The Empirical Data Indicate About ADR.* Retrieved 18 May 2017 from http://www.metrocorpcounsel.com/articles/4732/cost-effective-fast-and-fair-what-empirical-data-indicate-about-adr.

22. METZLOFF, T. B. Alternative Dispute Resolution Strategies in Medical Malpractice. *Alaska Law Review*, 1992 (Vol. 9, No. 2).
23. MOLEK, P. (2012). *Právo na spravedlivý proces.* Praha: Wolters Kluwer.
24. MORREIM, H. Malpractice, Mediation, and Moral Hazard: The Virtues of Dodging the Data Bank. *Ohio State Journal on Dispute Resolution*, 2012 (Vol. 27, No. 1).
25. Out-Law.com. (2011). *Institutional vs. 'ad hoc' arbitration.* Retrieved 17 May 2017 from https://www.out-law.com/en/topics/projects--construction/international-arbitration/institutional-vs-ad-hoc-arbitration/.
26. PETROV KŘIVÁČKOVÁ, J. (2015). Rozhodčí řízení. In R. ŠÍNOVÁ, J. PETROV KŘIVÁČKOVÁ, Jana (ed.), *Civilní proces. Řízení nesporné, rozhodčí a s mezinárodním prvkem.* Praha: C. H. Beck, 2015.
27. SEKHAR, M. S., VYAS, N. Defensive Medicine: A Bane to Healthcare. *Annals of Medical and Health Sciences Research*, 2013 (Vol. 3, No. 2).
28. SIME, S., BLAKE, S., BROWNE, J. (2011). *A Practical Approach to Alternative Dispute Resolution.* New York: Oxford University Press.
29. SMOLÍK, P. (2014). Alternativní řešení sporů. In A. WINTEROVÁ, A. MACKOVÁ (ed.), *Civilní právo procesní. První část – Řízení nalézací* (7th edition). Praha: Linde.
30. SOHN, D. J., BAL, B. S. Medical Malpractice Reform: The Role of Alternative Dispute Resolution. *Clinical Orthopaedics and Related Research*, 2012 (Vol. 470, No. 5), p. 1370-1378.
31. SZMANIA, S. J., JOHNSON, A. M., MULLIGAN, M. Alternative Dispute Resolution in Medical Malpractice: A Survey of Emerging Trends and Practices. *Conflict Resolution Quarterly*, 2008 (Vol. 26, No. 1).
32. ŠUSTEK, P. (2016). Pacient z pohledu práva EU. In P. ŠUSTEK, T. HOLČAPEK (ed.), *Zdravotnické právo* (p. 198-204). Praha: Wolters Kluwer.
33. Universal Declaration on Human Rights. (1948).
34. WADE, Gordon. (2010). Mediation: Article 6, Mandatory Mediation and the Hallmark of Democracy. *CPD Seminars*. Retrieved 19 May 2017 from https://www.cpdseminars.ie/articles/mandatory-mediation-and-the-hallmark-of-democracy/#_ftn17.
35. ZUMETA, Z. Styles of Mediation: Facilitative, Evaluative, and Transformative Mediation. *Mediate.com.* Retrieved 17 May 2017 from http://www.mediate.com/articles/zumeta.cfm.

LEGAL ASPECTS OF SOCIAL WELFARE SYSTEM 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

The paper draws attention to the fundamental features of the social welfare system in the city of Osijek. The author analyzes the historical development of social assistance and social welfare, the basic principles of social policy and elements of the social welfare system in the city of Osijek in the late 19th and the early 20th century. Social welfare as an independent administrative branch of administration belonged to the autonomous affairs of the Kingdom of Croatia and Slavonia, and to the administrative law. Caring and activity in the social welfare belonged to the local government. So, the supply of the poor was the responsibility of the municipality. Thus, in terms of social welfare in the cities of the Kingdom of Croatia and Slavonia, what was relevant was the legal article 72 of the Law on the organization of the city municipality of 21 June 1895, pursuant to which, the sphere of the city council also includes the supply of the poor. However, apart from these general institutions, statutes created in urban repesentations and approved by the government, also contain special institutions concerning the social welfare foundations, sharing support and management. Therefore, the city representation of Osijek in 1902 drafted a statute which regulated the supply of the poor in the city of Osijek. Also, in addition to the so called social welfare cash registers for helping the poor, there were also individuals who were the founders of such foundations. Consequently, in this paper we are going to describe the activities of a few foundations in Osijek which were established during the 19th and 20th centuries, and which distinguished themselves for their actions about the care for the infirm and the poor. Special attention was paid to the description of the protection of children without parents (orphans) which fell under the city protection because there was a city poverty office within the city (the Poverty commission and the treasury).

Keywords: *local government, protection of children without parents (orphans), social welfare foundations, social welfare system*

1. INTRODUCTION

Social welfare as an independent administrative branch belongs to the autonomous affairs of the Kingdom of Croatia and Slavonia, i.e. administrative law. It is in close connection with the custody, and if a person lacks material resources and there is no way of getting them, it is a state of destitution, necessity, poverty. Causes can be diverse, that is, subjective and objective, that is, they can be the will and the act of an individual (rampancy, negligence), and they can be external influences. Accordingly, poverty can be occasioned and unoccasioned, but the effect is the same: economic incompleteness that can, nevertheless, become and it often does become dangerous for the state's state of affairs. Namely, destitution causes the crime and it is the duty of state administration on the one hand to care for the help of the poor, and on the other hand, to remove with the decisive means adverse consequences of poverty for the society. One should be aware of the individual diversity that is manifested in the poor and which is of crucial importance for the administrative activity in this area. Poor people can be those who are unable to work because of physical inability; people who are capable to work but lack the opportunity to do so, i.e. they have no earnings and people who are also capable to work but lack the will to do so.

In the real sense, the subject of poverty is a person unable to work because of a physical disability, and this is where the administrative authority must endeavor to enable the actual survival of those persons, while with the persons capable of work the city police, as the "social welfare police", must act directly, either preventively or repressively. These persons are not in the true sense the subject of the social welfare, but under the various circumstances they are the subject of internal administration as social ones (Žigrović-Pretočki, 1911, pp. 268-274).

2. SOCIAL WELFARE IN THE AREA OF THE CITY OF OSIJEK

Caregiving and business activities in the social welfare affairs belong to the local self-government. Thus, the municipality is in charge of the supply of the poor, and the duty of the state and the municipality to support the poor is a part of public law. Thus, with regard to urbanization in the areas of the cities of the kingdom of Croatia and Slavonia, the legally binding Article is the Article 72 of the Law on the Establishment of Town Halls of 21 June 1895, under which the supply of the poor belongs to the scope of the municipal assembly. In addition to this law, other legally binding provisions were the provisions of the Law on Homeland Relations of April 30, 1880, and in particular the Decree of the Chamber of Deputies, of the internal department of December 11, 1874 concerning the institutions dealing with public supply of the poor in the competent municipality, public social welfare and health care institutes[1], as well as the Order of May 4, 1881.[2] However, apart from these general institutions, the statutes created in the city councils and approved by the Governments, also contain special institutions regarding social welfare funds, grants and management. Therefore, the City Council of the City of Osijek at its session held on November 28, 1902 accepted the proposal of the city representative Hugo Spitzer to draft a statute on the basis of which the supply of the poor in Osijek will be regulated and the necessary funds for this purpose will be provided. Putting this proposal into the agenda of the city session Spitzer states two reasons for this: in one hand, the funds used to supply the poor are decreasing year by year, and on the other hand, not only does it not seem that these needs will fall, but rather that existing opportunities allow a reasonable conclusion that these needs will grow every day. That the coverage is decreasing is proved by only one glance at the budget of the year 1903. It shows that the city of Osijek is running a deficit and that the revenue from the fixed assets is not sufficient to meet the most demanding requirements in terms of supplying the poor. In addition, it must be borne in mind that this income, as systematized so far, has to fall, on the one hand because a part of it is not permanent anyway, as it depends on the spontaneous will of the individuals, and on the other hand because a large part of the fines, that were until then intended for the local community funds, now belong to the foundation for the renovation of prisons and correctional facilities. Ultimately, it must be assumed that the other revenues, which until now has covered the costs of the social welfare, will be reduced, and these are the entertainment permits, because, given the economic circumstances, there will not be any particular interest to issue such permits. Also, such opportunities are also a proof of the fear that the need for the supply of the poor will increase, because at the time when the income of domestic workers and tradesmen drops evidently, when the people who have been up to date able to support themselves and their families are doing their job most of the year without the income, it cannot be any other way but to have these people as well falling under the social protection of their city community.

[1] Collection of Laws and Orders valid for the Kingdom of Croatia and Slavonia. (1875). Sbornik zakonah i naredabah valjanih za kraljevinu Hrvatsku i Slavoniju, No. 1.
[2] Ibid, year 1881, No. 41.

All of this above has stimulated the city representative Spitzer to draft the Statute on the basis of which the reform of the city social welfare will be made. [3] According to the Statute for Public Social Welfare in the free and royal city of Osijek, the city municipality is obliged to provide its domicile people or citizens (Articles 9 and 11 of the Law on the Establishment of City Municipalities of 21 June 1895) such support at their own expense if they are impoverished and seek support by themselves, or if such a support is suggested to them. Likewise, other non-domicile municipal citizens who have lived in the municipality at least ten years from the day of impoverishment in the Osijek area and have paid public taxes, can be allow the supply by the city council or the support from the municipal funds. However, in the case of emergency, the city municipality must help all the poor non-domicile people living in Osijek, but in these cases it is entitled to claim return from the domicile municipality of the respective person in need. [4] From such cases arises the duty of the city community to support and supply only if the person in need is not provided help by existing community charities and institutes and if third parties are not obliged to do so under the existing regulations or contract. If there are such persons and they do not perform their duties, the city municipality will take over the supply with the right to claim return against the obliged person. Whether or not there are such persons, why they are legally bound to help the poor, and whether or not they are allowed by the circumstances to meet their obligations are the questions decided by the city government, and against these decision there is a right to appeal to the Royal Government of the Land. No poor person has the right to demand the way and the extent to which he should be supported by the city resources. The decision is made by those bodies which are, based on this Statute, invited to exercise the social welfare on behalf of the city municipality. Thus, the duty of the city municipality is subsidiary. For the purpose of evidencing all the poor supported by the funds of the city municipality, there will be a central cadaster established and managed by the city government. This cadaster has to include all the domicile people and persons permanently residing in the area of Osijek, and who are referred to the social welfare office. The City Municipality carries out its duty on the basis of the provisions of the Municipal Assembly of 21 June 1895, i.e. the duties for the poor described in the aforementioned provisions of the Statute, and this in particular refers to: full supply, support and assistance. The full support includes supply of the poor with all that he needs for life, free treatment in case of illness, and a decent burial upon his death according to the religion to which he belongs. The right to this type of support is given to poor people who are incapable of work, then those who have reached the age of 30, patients who can not be nursed in a hospital or health center or who have been relieved of treatment for incurable illness, as well as mentally ill, deaf and blind persons. According to the number of available places, the adult poor people, and in particular those who due to physical weakness, incurable illness or physical disabilities can not serve themselves should be placed in a city shelter for the poor at the expense of the city municipality. In the event that they can not be placed for a reason in the city shelter or a private institute, they will be taken care of by third parties at the expense of the city municipality. The shelter will be provide only by those parties whose reliability in every respect has been determined by the city government and who can be subjected to daily and unconditional control by the public social welfare bodies.

[3] See more in: Državni arhiv u Osijeku (HR-DAOS-6, GPO), The city statutes, box No. 5909. (A letter sent to Konstantin Graff, king's advisor and the mayor of free and royal city of Osijek from the city representative Hugo Spitzer; in Osijek, 24 December 1902).

[4] In the context of this statute, a poor person is the one who is not capable of supporting neither himself nor those that he must support by the law, with his own power and his own resources (article 4), see in: The statute for public social welfare in the free and royal city of Osijek; HR-DAOS-6, GPO, The city statutes, box No. 5909.

The party who provides shelter for the poor must provide an adequate accommodation, clean bedding, adequate clothing and footwear, healthy food etc. These terms are contained in a contract that binds the party. The City Council issues a house rules, which must be followed by all the poor, and the supervision of the city shelter of the poor is made by a special committee elected by the city council. [5] The purpose of the aid granted from the municipal funds is to supplement its own insufficient funds. Accordingly, the right to an aid belongs to those persons who are temporarily incapable of work or have their workforce so reduced that they cannot take care either for themselves or for those who they are legally required to care for or fully support by their own means. In particular, the right to an aid belongs to these persons: a) who have lost their ability to work while they are ill; b) Furthermore, those who, because of the illness, have got so weakened that they cannot permanently earn as much as they need for life; c) those who are capable to work but cannot find a job and they can prove it; d) children who cannot be properly cared for by their parents for the above reasons; whose father died, and whose mother lives in destitution; whose parents died, and the relatives taking care of them cannot provide the full care. The aids are permanent or temporary depending on whether the condition is a permanent state or temporary one. Permanent support is granted until recall, while temporary ones are granted at a time the condition of the need is likely to last. However, temporary aid can be extended, if the state of the need persists over the foreseen time, and, on the other hand, permanent aid may be suspended as soon as the reason for which they were permitted no longer exists. Also, the aid may be suspended for the following reasons: a) if the time elapsed for which the aid was granted and the extension is not required or is not permitted; b) if it turns out that it is not at all or sufficiently needed; c) if it is not collected within three months; d) If an aided person dies, or if he is received under full supply (Articles 25-29).[6]

The right to obtain assistance can be granted to people currently in need and at that moment unable to provide the family and themselves with the necessary things for life, such as food, clothing and footwear, etc. It is in general basic material assistance, and only exceptionally in cash, but it must always be evaluated to the strictest rules. As a rule, the amount of money can not exceed 20 crowns, but in exceptional cases, such as in the case of a family eviction, 30 crowns can be granted. Just as the city council can not deny the support of foreign buyers, so they have the right, as the domiciles of Osijek, to free medical help and free medicines. [7] Therefore, the way in which the assistance is to be carried out is determined by the municipality itself according to existing laws and regulations. Certainly, this provision belongs to the municipal sphere of competence, that is to say city representation (Žigrović-Pretočki, 1897, p. 39).

In addition to the so-called "treasury for the poor", from which the poors were materially aided, there were also charities founded by the individuals that functioned in such a way that the money from the equity interest was allocated as an aid to those to whom the founder of the charity had intended. The assets of the fund remain constant, while the funds intended for the purpose are used from the interest and income. The foundations had their own governing bodies and they distributed funds for educational, cultural, religious, political, social or other general purpose through support to associations, charities, educational institutions, individuals or through their own programs. In Croatia at the beginning of the 20th century there were even 220 registered foundations.

[5] Ibid, Article 1-25.
[6] Ibid.
[7] See more in: Statut za javno ubogarstvo u slob. i kralj. gradu Osijeku *[The statute of public social welfare in the free and royal city of Osijek]* (Article 33-42); HR-DAOS-6, GPO, The city statutes, box No. 5909.

Also in Osijek there were a number of foundations (Sršan, 2005, pp. 199-222) and humanitarian associations that, together with the city authorities, aided the helpless, the poor, children, poor students, widows and other socially vulnerable groups of society.

Already since the second half of the 18th century there was an Institute of Material Assistance for the Disadvantaged and Ineffective in Osijek and separation from the city cash register for this purpose. During the second half of the 19th century, this was a permanent item of the city budget, on the basis of which the elderly and the infirm were receiving permanent financial assistance, while working people, if they had learned some crafts, helped the city to get the basic tool needed for work and survival.

In the following section, we will describe the activities of some foundations in Osijek, which were founded during the 19th and 20th centuries, and which have been highlighted by their care for the helpless and the poor. From a series of foundations that were then operating in Osijek, the most famous and financially strongest was the Hutler-Kohlhofer-Monsperger Foundation (Sršan, 1997, pp. 291-293). From this very wealthy foundation there was built an orphanage and at that time a modern hospital in the Lower Town (1874). The significance of this foundation can be seen from the speech of the city representative Reisner at the session of the city government in February 1894, where he said "that it would be worthy enough for the city to remember in a decent manner all charity foundations and in particular those like Huttler-Kohlhofer-Monsperger, Deszathy, and Jager, and that their names should be engraved in a memorial panel and displayed in the city hall. Voted unanimously" (Sršan, 2007, p. 639). Three streets were named in Osijek after the names of the three founders of this foundation.

According to the financial value the second one was Adele Desathy foundation which founded the building of the Upper Town shelter for the poor. In 1885, it left 80 000 forints for the poor of the city of Osijek and for the city shelter (Sršan, 2006, p. 472). According to the will the money should be invested in a productive way with no delay for the people's security as well as to issue proclamation for this purpose" (Sršan, Sršan, 2006, p. 485-486).

The charity of Mijo Čeh, which was left in a will on March 12, 1889, had a value of 92,800 crowns in 1900. The funds of the foundation were intended for "mentally ill people who will receive assistance in this institution... that on the cost of that foundation the city representation (…) will receive only harmless mentally ill domiciles of Osijek who are poor and whose illness is of mild nature." (Sršan, 2008, p. 565). The sources also mention other foundations such as the foundation of Queen Elizabeth, the foundation of Lovro Jager, the foundation of the spouses Ivan Nepomuka and Juliana Hummel, the foundation of Adolf Krausz, the foundation of Antun Rotter, the foundations of Felix Ježević[8] and the Sorger Foundation (Sršan, 2008, p. 576).

2.1. City Social Welfare Administration and Committees

In addition to the city government, as a part of the town's social welfare administration, there are also committees that have the task, on behalf of the city council, to take care that everyone, who by the law or this Statute has the right to social welfare assistance, receive the relevant support or assistance; also the funds available to social welfare offices are to be used for the proper purpose and not to be misused.

[8] The city of Osijek received 27 175 crowns and 78 forints for the erection of six social welfare committees in the city of Osijek, which will be under its authority.

For this purpose, there were six board committees established in Osijek, consisting of 16, 12 and 10 members, depending on the part of the city they were located at. [9] Members of the board, the so-called social welfare councilors are elected by the city council for a period of six years, counting from the last election of the city's representative. Every third year, half of the members of each board are exited, and the first session is decided by a draw. The councilor's service is free and honored, and every male from the municipality who has reached the age of 24 may be elected, provided that he is chaste and resides in the area of that committee. The social welfare councilors of each committee choose among themselves the head of the committee, the deputy head, the secretary and the cashier. The social welfare committees perform their duties through their individual members, the head of the office or his deputy and board assemblies. Each individual councilor is a self-proclaimed body of public social welfare affiliation, invited to perform his vocation in the area he is assigned to. Whenever he is approached by the poor or in cases when he himself or through a third party finds out that there is a person in need, he must accurately and thoroughly examine all the decisive circumstances and arrange it on the basis of his own perception and conviction. If the councilor can not find enough proof of whether the conditions required for obtaining the support exist, he will have to contact the city administration which will be required to provide him with the necessary information. If the councilor evaluates that the support is unnecessary, he will reject the appeal and notify the next board meeting thereof. On the other hand, if the councilor is convinced that the person is in need of support, he or she can determine, in case of need, a fee of up to 10 crowns or with the signature of the head of the board up to 20 crowns. In other cases, he will make a proposal, together with a report on the conducted surveys, to the next Board meeting for the resolution of the case. If the allowance is approved and granted to the poor who does not meet the necessary conditions, it must immediately reported to the city administration for the purpose of obtaining return from the local government.

Also, the social welfare councilor supervises the guardians of adult or underage poor. If the councilor notices a few disadvantages, he will try to remove them with his advice and instructions. However, as soon as they are convinced that the welfare of the child is compromised, if he continues to stay with the same guardian, he will have to report it without delay to the head of the board, who will then, in agreement with the district governor, determine further steps. In particularly urgent cases, the councilor may take such a provision alone, but with the subsequent approval of the board of committees of the city government in question. In addition to this, the head of the board also supervises the work of the councilor, briefs new members, visits the poor located in his area, etc.

[9] According to Art. 47 of the Statute, the following six board committees were set up in the city of Osijek: "For the upper town: the social welfare committee I, which covers the streets: Domobranska, Kolodvorska, Gundulićeva and Vašarište, Sunčana, Deszathyeva, Školska, Adamovićeva and Jagerova, Kapucinska, Šamačka and Županijska, then Žitni trg and the square of Count Khuen-Hedervary, Pejačević's street to the Lončarska street and Franjina street; Social welfare committee II which includes: Gundulićeva street and Vašarište from the crossroads of Župnijska street to the end, Tvornička street, Lončarska, Anina street, Ružina, Ilirska and Nova street to the crossroads of Rokova Street, Kokotova, Pejačevića street from Lončarska street, Rokova street and Duga street until the church of St. Rocco; social welfare committee III which covers all the other streets of the upper town. For the lower town: social welfare committee IV, which includes Huttlerova, Gvozdena, Paromlinska, Biskupska, Vodenička, Krstova and Crkvena Street to the Cvetkova crossroads, Tržna and Gospodska street, state road, Široka and Željeznička street to the crossroads of Cvetkova Street, Cvetkova street and square; Social Welfare Committee V, which covers all the other streets of the lower town. For the fortress and the new city: the social welfare committee VI. Social welfare committees I, II and III each consisting of 16, committees IV and V each of 12 and the committee VI of 10 members, bearing the title "social welfare councilor's", see: Statute for Public Social Welfare in free and royal city of Osijek; HR-DAOS-6, GPO, City Statutes, box No. 5909.

He represents the board of directors for the city municipality and in the central social welfare council he commends the remittance, support and supervises their payment. He supervises the treasurer's business and chairs the board meetings. If the head is prevented, all his duties are performed by his deputy. [10]

Committee sessions should normally be held once every month, but the head of the board is authorized to convene an extraordinary session. At least half of the members of the committee concerned should be present in order to make valid conclusions at the committee meeting. Conclusions are made by a majority of votes, and if the votes are equally distributed, the chairman votes as well. The scope of the committee meetings include: the board reports, a decision on the proposals of social welfare councilors; subsequent approval of the support and assistance permitted by the councilors or chief of the board; decision to extend, increase or suspend permanent and temporary aid; the decision to receive a poor in full supply (outside the shelter) and to determine the level of supply; election of the head of office, deputy, cashier and secretary[11]; to make suggestions aimed at improving or transforming the social welfare in the area of the respective committee (Articles 29-71). [12]

The central social welfare council has the duty to promote charity in the area of the city, to advise on the improvement of public social welfare issues, to give opinions on issues of fair and equal supply of the poor and to strive to harmonize public social welfare by the involvement of all invited factors. The chairman of the central social welfare council is the mayor, who, in the event of his disqualification, is replaced by a deputy appointed by him. In addition to the mayor, members of the social welfare council are also: the social welfare municipal reporter of the city government, the legal reporter of the social welfare committee, the city physician, the four city representatives elected by the town representation, the heads of all board committees, one of the patrons of every existing religious association in Osijek and finally one member of all existing charities and institutes in Osijek. It shall meet in sessions which, if necessary or on the basis of a proposal of any member, shall be convened by the President. Concluding remarks must be communicated to the city council and board committees.

The costs of public social welfare were covered by the interest rates of the city social welfare councils and the ones entrusted to the city administration and the charitable foundations; from the fines determined by the city government, unless they belong to the foundation; from fees paid for dance licenses and for permits enabling taverns and cafes to remain open beyond regular hours; from voluntary proceeds, alms and records and from the social welfare surtax. The interest rates of some foundations organized for the purpose of supporting the poor will be distributed by the city government through the board committees, based on their proposals; while the interest from other foundations will be used by the city government for the institutions of the respective foundations. If they are not intended for special purposes, voluntary proceeds and alms will, if necessary, be donated for "financial foundation“ administered by the mayor. The excess of this amount shall be proportionally allocated to the

[10] Ibid.
[11] The cashier manages the treasury of the board in question, pays support and helps, draws a cash journal and compiles the monthly statement of the need for the city cash register. The secretary conducts all the secretarial duties and keeps the record at the committees, see: Statute of public social welfare in free and royal city of Osijek (Articles 67-68); HR-DAOS-6, GPO, City Statutes, Article no. 5909.
[12] Ibid.

respective social welfare committees and according to the probable need. [13] The amount required to cover the costs of public social welfare, and is not covered by the above income, must be covered from the social welfare surtax. The height of the social welfare surtax is determined by the commission elected by the City Council for a period of three years. It consists of eighteen members, out of which the six members of the first electoral unit, eight members of the second electoral unit and of four members of the third electoral unit. The president of the commission is a mayor, and if he is prevented, it is a deputy or a city representative appointed by the mayor. The Commission can make valid conclusions only if two-thirds of all members are present, and it concludes by a simple majority of votes. The chairman and reporter (head of city accounting) do not vote, and if the votes are equally distributed, the lower surtax is accepted. Against the Commission's conclusion, there is a right to appeal to the city's representation. It must first be filed with the city government within 14 days of the date of delivery of the decision. However, there is no legal remedy against a city council decision (Articles 72-87). [14]

2.2. The city social welfare committee and treasury

In Croatia, care for children began to be exercised early, and there was care provided for children and young people exposed to poverty, alcohol, children born outside marriage, incomplete families, neglected and abandoned children, and children without parents. Given that during the 19th and early 20th century many children were left without parents, and there was also a large number of incapacitated children, the state authority took care of them and laid down guards and guardians. Thus all male children under the age of 24 were underage as well as women under the age of 16. Underage children under the age of 12 were under the authority of their parents or guardians, while those under the age of 12 were legally underage, i.e. they could claim their rights before the court. Men of age after reaching the age of 24 were eligible to earn their property rights, while women after the age of 16 were still under the custody until their marriage, or by the age of 24, when they were eligible to manage a part of their property. Therefore, all underage children were placed under the guard until they reached the statutory age when they came under guardianship (Ratković, 1920, pp. 58-67). Poor children without parents fell under the city's guardianship. Namely, there was a city office for the poor (social welfare committee and treasury) that was taking care of such children. It was founded to help the poor and hungry citizens of Osijek. The commission supervised the social welfare treasury and carried out the tasks of tutoring and protection. The commission consisted of a district judge as the mayor (president) and at least four members

[13] Collecting (yielding) alms in public charitable and general-purpose purposes is governed by the order of internal section of March 8, 1898, no. 15. 241., on the basis of which it is permitted only with the prior permission granted to the area of the capital city of Zagreb, Osijek, Varaždin and Zemun city governorship (Article 102 of the Law of 21 June 1895 on the Establishment of City Municipalities) for districts, 2nd types of county, or county districts (Article 41 of the Law of 5 February 1886 on the establishment of the counties), and for the whole territory of the country, the land government. These permits of county districts and city authorities can be provided for the benefit of the injured person for a maximum of 60 days and for general charitable purposes for a year, while for extended permits the land government. County Areas and city authorities may issue similar permissions to such persons and for the benefit of such persons who permanently reside in their territory, or in favor of companies and corporations having their head office in their area. Yields that have been collected without permission must be confiscated and used for general charity purposes, and the collectors must be brought the to the administrative area which for the misdemeanor of the aforementioned order issues fines of 10 to 200 crowns in favor of the social welfare foundation of the municipality where the offense was committed or 1 to 20 day imprisonment if there is no right to institute criminal proceedings. With regard to confiscated yields and objects, the decision is pronounced in the first plea by the county districts, i.e. city authorities of the cities of the first type, see: *Collection of Laws and Orders]*, No. 19, 1898.

[14] Statute for the public social welfare in the free and royal city of Osijek (Article 67-68); HR-DAOS-6, GPO, City Statutes, box No. 5909.

elected by the municipal assembly. One of the main jobs was for the Commission to write down all orphan inventory. They also had the authority to decide on setting up guardians or protectors for the children and young people who needed it by the court's decision. The task of the guardian was to take care of the property of a young person up to her/his age, to take care of the education and raising of a juvenile, to teach him morality and decency, to represent him in court and outside the court while sticking to the rights and regulations. The city administration was entitled to regular annual supervision, and even more often to check the property administered by the designated guardian or protector. Each year the guards have to present the account for asset management and expenses to their protégés. For their efforts they were entitled to 1/6 of the property of the protégé.

The property of the protégé was regularly sold on a public auction, and the money was stored in the city social welfare treasury and then lent to citizens with interest. However, it was often the case that the commissioners could not return the money or that the caretakers badly dealt with the property or the protégés, so in those cases the city, i.e. its social welfare committee and the treasury had to intervene.[15]

Prior to the adoption of the law regulating the institutional form of accommodation for children (the Children's Homes Act), the funds for the organization and operation of the first children's homes were provided by the Foundation. The example are the three children's homes in the continental part of Croatia, one of which was founded in Osijek in 1870 by the funds from the Huttler-Kohlhiffer-Monspreger Foundation (Petrak, 2005, pp. 7-24). This is important to mention because this institution in Osijek has existed throughout the entire analyzed period, and it still exists today. It only changed its name and location, but it has never changed its basic activity - child care.

Thus, the first law regulating the placement of children outside the family is the Law on Children's Homes, adopted in January 1918, which clearly states that care for abandoned children under the age of 15 is assumed by the state in Croatia and Slavonia. This Law also defines the way children are left to care: "All children left are admitted to children's homes. Only those who are sick, weaker and those children who need special care and medical assistance remain in these homes, the remaining children are regularly placed outside the children's homes." The law further states: "To this end, Zagreb and Osijek children's homes are established".[16] The children's home was run by a special committee chosen by the city's representative. The home of the city was supported by the subsidies of the city and the donations.

3. CONCLUSION

According to historical sources, care for the sick, helpless, poor, abandoned children dates back to the Middle Ages, and we are still witnessing it today. With the development of the civil society, awareness of the need for care of the weak, the helpless and the children has increased, and this role is increasingly being taken over by the state. Social welfare as an independent administrative branch of administration belonged to the autonomous affairs of the Kingdom of Croatia and Slavonia, and to the administrative law. Caring and activity in the social welfare belonged to the local government. So, the supply of the poor was the responsibility of the municipality. Therefore, the city representation of Osijek in 1902 drafted a statute which regulated the supply of the poor in the city of Osijek.

[15] HR-DAOS-6, GPO, Social welfare committee, box No. 2075-2076.

[16] Article 2 of *The Law on Children's homes*, 1918. See more in: Šilović, J., Zaštita djece. Sadanje stanje i pogled u budućnost. *[Protection of children. Present situation and view in the future]* Zagreb: Naklada "Narodne zaštite", 1922.

Also, in addition to the so called social welfare cash registers for helping the poor, there were also individuals who were the founders of foundations from which the poors were materially aided. In Osijek there were a number of foundations and humanitarian associations that, together with the city authorities, aided the helpless, the poor, children, poor students, widows and other socially vulnerable groups of society.

LITERATURE:

1. Collection of Laws and Orders valid for the Kingdom of Croatia and Slavonia. (1875). *Sbornik zakonah i naredabah valjanih za kraljevinu Hrvatsku i Slavoniju*, No. 1.
2. Collection of Laws and Orders valid for the Kingdom of Croatia and Slavonia. (1881). *Sbornik zakonah i naredabah valjanih za kraljevinu Hrvatsku i Slavoniju*, No. 41.
3. Collection of Laws and Orders valid for the Kingdom of Croatia and Slavonia. (1898). *Sbornik zakonah i naredabah valjanih za kraljevinu Hrvatsku i Slavoniju*, No. 19.
4. Petrak, J. (2005). *Od Zakladnog H-K-M sirotišta do Doma za djecu Klasje: Povijest (institucionalne skrbi o djeci u gradu Osijek) duga 135 godina*. Osijek: Dom za djecu Klasje; Cerna: Tiskara Pauk.
5. Ratković, S. (1920). *Savremeno staranje za djecu i mladež*. Zagreb: Tisak Kr. zemaljske tiskare.
6. Šilović, J. (1922). *Zaštita djece: Sadanje stanje i pogled u budućnost*. Zagreb: Knjižnica "Narodne zaštite".
7. Sršan, S. (1997). *Izvori za povijest zdravstva Osijeka i Hrvatske: 1874. -1923*. Osijek: Klinička bolnica: Povijesni arhiv.
8. Sršan, S. (2005). Stare osječke zaklade do 1936. godine. In S. Sršan (ed.), *Glasnik arhiva Slavonije i Baranje*. Osijek: Državni arhiv.
9. Sršan, S. (2006). *Zapisnici grada Osijeka: 1876.-1886*. Osijek: Državni arhiv.
10. Sršan, S. (2007). *Zapisnici grada Osijeka: 1887.-1895*. Osijek: Državni arhiv.
11. Sršan, S. (2008). *Zapisnici grada Osijeka: 1896.-1901*. Osijek: Državni arhiv.
12. The Law on Children's homes. (1918). *Zakon o dječjim domovima.*
13. The statute for public social welfare in the free and royal city of Osijek. (1902). *Statut za javno ubogarstvo u slobodnom i kraljevskom gradu Osijeku*.
14. Žigrović-Pretočki, I. (1897). *Zakoni i naredbe o upravi gradskih i seoskih občina u kraljevinah Hrvatskoj i Slavoniji.* Zagreb: Tisak i naklada Knjižare Lav. Hartmana.
15. Žigrović-Pretočki, I. (1911). *Upravno pravo kraljevina Hrvatske i Slavonije s obzirom na Ustav.* Bjelovar: Tisak Lav. Weissa u Bjelovaru.

ALTERNATIVE DISPUTE RESOLUTION FOR CONSUMER DISPUTES IN CROATIA AND EU

Maja Proso
Faculty of Law, Universitiy of Split
Domovinskog rata 8, 21 000 Split, Republic of Croatia
maja.proso@ gmail.com

ABSTRACT
This paper presents the development of alternative dispute resolution for consumers disputes mechanisms in Europe and analyses the current Directive 2013/11/EU of the European Parliament and of the Council on alternative dispute resolution for consumer disputes (ADR Directive) and the Regulation (EU) No 524/2013 of the European Parliament and of the Council on online dispute resolution of consumer disputes (ODR Regulation), as well as newly enacted legal framework of the Republic of Croatia in relation to out-of-court dispute resolution for consumers disputes which will enable consumers residing in EU as well as traders based in the EU, in a quick, efficient and easy way to use the Internet to resolve cross-border and national disputes and in front of authorities for alternative dispute resolution. This will contribute to the more efficient consumer protection which is also important for the functioning of the EU internal market and boost of economic growth.
Keywords: *alternative, consumers, Directive, disputes, European Union, online*

1. INTRODUCTION

Consumers are the largest economic group, are considered to be the regulators of development of the economy and have a direct impact on the business policy of businessmen and the competitiveness of the market. Therefore, the consumer protection an important part of the internal market of the European Union, which directly affects the economic growth and development. Digital dimension of the internal market in the EU is becoming crucial for both consumers and traders. Alternative dispute resolution (hereinafter: ADR) represents the out-of-court resolution of disputes between consumers and traders. (Tepeš, 2009., p. 190) The possibility to find a simple dispute resolution can boost the confidence of consumers and traders in the digital single market, and in such a way as to bridge the barriers to finding solutions to disputes arising from cross-border online transactions. In a recently released study by the Central Bureau of statistics on the use of information and communication technologies in households for 2016. (Usage of information and communication technoloigies (ICT) in households and individuals, first results, 2016.) has shown that almost all households in Croatia use the broadband Internet connection, and increases the number of households which access the Internet via mobile networks. Thirtythree percent, or one-third of Croats purchased goods and services over the Internet last year, and majority has bought household items, clothes and sports equipment, tickets for shows, electronic equipment and parts for computers.

The existence of effective, fast and cheap way of resolving domestic and cross-border online and offline consumer disputes, can contribute to increasing the awareness of consumers about their rights and to increase the confidence of traders and consumers in the single market, which could have an effect on the economy as a whole by increasing the national and cross-border transactions. The idea of an alternate mode of dispute resolution begins to develop in Europe in the second half of the nineties of the 20th century by way of directives and recommendations that govern the subject matter specified in various areas. (Directive 2007/64/EC of the European Parliament and of the Council of November 13th. 2007 on payment services in the internal market amendingDirectives 97/7/EC, 2002/65/EC,

2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC). The potential of use of online settlement was predicted by many experts, (Cortes; Lodder, 2014, p. 19) encouraging ARD as the fastest and most effective, also the flexible and informal way of resolving a dispute for both parties, (Hodges; Creutzfeld, 2013., p.5) creating a network of extrajudicial dispute resolution method, or an appropriate system for the out-of-court, without contact, the auto-generated (Blake; Browne; Sime, 2012., p.71) resolving consumer disputes (Fogh Knudsen; Balina, 2014., p. 944) are the recommendations of the European Union (Urša; Uzelac, 2014., p. 46 – 48)

2. THE LEGAL FRAMEWORK FOR ALTERNATIVE RESOLUTION OF CONSUMER DISPUTES IN THE EU

In November 2011, the European Commission presented the two main proposals in the area of alternativnoge ways of resolving disputes: the draft Directive "The ADR for consumer disputes (COM (2005) 793/2) and the proposal Regulation "on online dispute resolution (ODR) for consumer disputes (C (2011) 794/2. (Hodges; Stadler, 2013., p. 263) So for resolving consumer complaints, which usually ended in big costs of court proceedings as well as the courts being overwhelmed with these lawsuits, was provided out of court model via the ADR system.

2.1. Directive 2013/11/EU of the European Parliament and of the Council of 21. May 2013. on alternative mode of resolving consumer disputes

In the preamble of Directive 2013/11/EU of the European Parliament and of the Council of May 21st. 2013. on alternative mode of resolving consumer disputes (hereinafter: Directive 2013/11/EU), it is indicated that alternative dispute resolution allows easy, quick and low cost, out-of-court resolution of disputes between consumers and traders (except for disputes in the sectors of health and education.) It notes on how alternative dispute resolution is not fully developed in the entire area of the European Union because consumers and traders are still not sufficiently aware of the existing extra judicial dispute resolution mechanisms, and the reason many consumers refrain from certain cross-border purchases and for which they do not have confidence that potential disputes with traders can be solved in a simple, fast and cost-effective way. The purpose of Directive 2013/11/EU is achieving a high level of consumer protection, to contribute to the proper functioning of the internal market and allow for consumers to out-of-court resolution of disputes in independent, transparent, effective, fast, fair alternative ways of dispute resolution. Article 2. Directive 2013/11/EU, determines the scope of the directive on procedures for judicial resolution of domestic and cross-border disputes on the basis of the contractual obligations arising from the contract of sale or services between traders established in the European Union and consumers residing in the territory of the European Union. Provision of Article 3. Directive 2013/11/EU, determines the relationship to other legal acts of the EU, and stresses the primary application of the provisions of Directive 2013/11/EU in the event of a conflict with the provisions that apply to out-of-court procedures initiated by consumers according to the dealer, while paragraph. 2. Article 3. specifies how the provisions of Directive 2013/11/EU does not call into question the Directive 2008/52/EC. Directive 2013/11/EU in Chapter III. (Information and cooperation), in Article 13, paragraph 1, states the obligation on the Member States to ensure that traders established in their territories inform consumers about the subject or subjects for ADR to which they are covered by those merchants. The information above must be clear, understandable and easily available through the Internet sites of the dealer or the General conditions of the contract for services between the trader and the consumer (if the Internet merchant's page does not exist). In the application of this Directive, Member States must ensure that the established entities of the member states competent for the resolution of

disputes ADR held the current Web page, which allows users simple access to the information and the filing of a complaint (or requests for out-of-court dispute resolution) with supporting documentation electronically, which does not exclude the possibility of filing complaints by way of regular mail or directly to ADR subject.
The Articles 5. and 7. of the Directive 2013/11/EU stresses the importance of the principle of transparency by requiring that the ADR Member States ' entities on network sites have listed contact information, data on membership in the ADR networks (which makes it easier to solve cross-border dispute), the types of disputes which are included in the competence of an individual ADR bodies, the procedural rules and procedural requirements for the submission of complaints, the language of filing of the complaint, the information about the costs of the proceedings, annual reports on the activity performed and the statistical data. For the effectiveness of ADR proceedings, the competent ADR subject Member States should allow the progress of the communication of the parties in the front row, by electronic means. It is important to note that the competent ADR bodies are obliged to act in accordance with the rules of the protection of personal data established by the national legislation implementing Directive 95/46/EC of the European Parliament and of the Council of October 24th 1995. on the protection of individuals with regard to the processing of personal data and on the free movement of such data.(Official Journal of the European Union, L 281/31.) In accordance with the General principles of ADR procedures, Member States shall ensure that a natural person who carried out the ADR procedures possess the necessary expertise, independence and impartiality (article 6. Directive 2013/11/EU). The principle of the effectiveness of the ADR process is reflected in article 8, according to which such acts should be cost free, or if the estimated payment of costs, they should be as a lower as possible. Reaction of the relevant ADR bodies should be urgent, with the procedure that should be completed within ninety days. In the case of very complex dispute, it is possible to extend the deadline with notification to the parties about the expected time needed to complete the operation. Each Member State had the obligation to specify the competent ADR organ as a single contact point of the European Commission, and to implement Directive 2013/11/EU in national legislations up to July 9th 2015.

2.2. Regulation of the European Parliament and of the Council of 524/2013 on the online solving consumer disputes

Regulation 524/2013 of the online solving consumer disputes (hereinafter: Regulation 524/2013) (Official Journal of the European Union L165/1) is applied to the out-of-court disputes initiated by consumers residing in the European Union against traders based in the European Union, which are covered by the provisions of Directive 2013/11/EU of the European Parliament and of the Council of May 21st 2013. on alternative ways of resolving consumer disputes (cross-border and domestic transactions online). The regulation on resolving consumer disputes on the Internet at the level of the European Union creates an interactive website for consumers and the marketers looking for the out-of-court resolution of disputes arising out of online transactions offering them a unique starting point (hereinafter: ODR platform). The platform should link all national institutions for alternative dispute resolution and be available in all official languages of the European Union. ODR platform could be defined as ” dispute resolution carried out by combining the information processing powers of computers with the networked communication facilities of the Internet” (Hornle, 2009. p. 74-75)
ODR platform should have the form of an interactive web site that will provide general information on how to resolve disputes between retailers and consumers arising from online sales and contracts, to which can be accessed free of charge in all official languages of the

Union. Basic tasks of the ODR platform, according to the provisions of article 5. Regulation 524/2013 are to provide an electronic complaints form for the complainant, to inform the opposing party of a complaint, identify the competent entity of the Member State that shall be responsible for resolving consumer disputes alternatively and to forward the complaint to the opposing party. It offers free electronic support for conducting extrajudicial dispute resolution, provide the parties and the body with the translation of information necessary for the resolution of the dispute through the ODR platform. Negotiation in ODR is thus generally considered to be crucial in resolving online disputes whilst in the initial phase it is able to resolve the highest number of the disputes. (Hornle, 2013, p. 198) In accordance with article 10. Regulation 524/2013 the procedure must be completed within 90 days since the competent entity has received a complaint. The right to a remedy and the right to a fair trial are the fundamental rights referred to in article 47. of The Charter of fundamental rights of the European Union (Official Journal of the European Union C 303/1), so the parties reserve the right to access to the justice system.

3. THE LEGISLATIVE FRAMEWORK OF ALTERNATIVE (OUT-OF-COURT) DISPUTE RESOLUTION IN THE REPUBLIC OF CROATIA

The development of ADR is of special interest for the Republic of Croatia as well, because of the possible positive effect on the national judiciary, more efficient, improving consumer protection and on economic development as a whole. The legal framework of ADR in the Republic of Croatia was created through the adoption of The Law on arbitration in 2001. and The Law on mediation in 2003.

3.1. The Law on mediation

The reason for the enactment of a new law on mediation was the necessity of modernization of the normative framework for reconciliation, development and general acceptance of the institute of conciliation , as well as the equal availability of mediation proceedings for the citizens of the European Union and Croatian nationals. Also, one of the goals of the enactment of a new law on mediation was the harmonisation with Directive 2008/52/EC of the European Parliament and of the Council of May 21st 2008. on certain aspects of mediation in civil and commercial matters.

3.2 The Law of civil procedure

The provisions of The Law of civil procedure gives the possibility to the Court that during the entire civil procedure it may propose to the parties settlement of the dispute in conciliation at the Court, off the Court, even after the filing of a legal remedy (Articles 186.d, 186.e, 186.f, 186.g.). It is open to the possibility that the parties provide an agreement that suggest mediation at some of the centres for conciliation, in which case the Court pause with the procedure. The deal concluded in conciliation in court has the significance of the court settlement. Conciliation procedures at the Court is led by a mediator from the list determined by the President of the Court.

3.3 The law on consumer protection

Without the existence of the law on the protection of the consumer, we would not be able to talk about any kind of systematic protection of these categories of economic operators. The law regulated the right to the legal protection of consumers when buying products and services and in other forms of acquisition of products and services on the market (provision of Article 1, paragraph. 1. point. 3.). Aarticle 5, paragraph. 1, item 27. defines long distance contract as the contract concluded between the trader and the consumer in the framework of

an organized system of sale or provision of services without the concomitant physical presence of the trader and the consumer on the one place where, up until the moment of conclusion of the contract and for the award of the contract exclusively uses one or more of the means of remote communication. The legislator has prescribed the duty of the dealer, in a reasonable period of time, prior to the conclusion of the contract, to notify consumers about the method of dispute resolution, and an indication of whether any specific judicial mechanism of dispute resolution is available, as well as damages as provided by the contract concluded at a distance and how and under what assumptions consumers can use this mechanism. In accordance with the recommendations of the EU, it was necessary to establish a system of an out-of-court resolution of consumer disputes, according to the planned alignment of legislation of the Republic of Croatia with the acquis of the European Union for 2015.

3.4. The Law on alternative resolving consumer disputes

The Parliament of the Republic of Croatia at the session held on December 15th 2016. has brought the Law on alternative resolving consumer disputes, (hereinafter : ZOARPS) which entered into force on December 23rd 2016. By making this legal text, the content of the Croatian legislation on the issue of alternative resolution of consumer disputes, was at last normatively aligned with those in the EU. ZOARPS regulates alternative solving of domestic and cross-border disputes between merchants based in Croatia and the consumer residing in the European Union. The basic purpose is to enable consumers to address disputes with traders before the authorities for alternative disputes resolution which shall ensure independent, impartial, transparent, legally effective, quick and low cost resolution of disputes, for the purpose of achieving a high level of consumer protection and the proper functioning of the internal market. Body for alternative resolution of consumer disputes (hereinafter: ARPS) has the fundamental duty prescribed by the provision in article 8. of The law on alternative resolving consumer disputes. Body for ARPS is due: through regularly maintained web pages to provide access to information about alternative dispute resolution processes; allow consumers filing proposals to institute proceedings by electronic means; to enable the parties, at their request, the availability of information on a permanent medium, to enable the exchange of information between the parties, by electronic means or, where necessary, by mail; to resolve domestic and cross-border consumer disputes, including disputes referred to in Regulation (EC) no 524/2013. and when resolving consumer disputes under this law, guarantee that the processing of personal data are in accordance with the special regulations governing the protection of personal data. The body for ARPS could also allow consumers to submit a proposal to initiate proceedings directly, by post, by fax or in some other suitable way. The Minister responsible for consumer protection policy (hereinafter: the Minister) according to the provisions of article 27. ZOARPS had issued a public call for expressions of interest of future body for alternative resolution of consumer disputes. It is quite possible that the alternative Court that already exist had submited requests to be qualified as a body for alternative resolution of consumer disputes (for example: the Association for consumer protection, Courts of honor of the Croatian court lawyers Association, Croatian Chamber of trades and crafts, Croatian Chamber of Commerce, Association for the conduct of mediation, etc.). The Minister on the basis of the submitted information shall make a decision which will set out the future bodies for the settlement of disputes. The provision in article 29. ZOARPS the contact point of a platform for online solving consumer disputes in Republic of Croatia (an Internet web platform that in February 2016 was launched by the European Commission, as the latest in a series of measures aimed at the advancement of alternative methods to resolve consumer disputes in the EU, appoints Department of the European consumer centre, whose function is to provide support for the

resolution of disputes related to the complaints submitted via the platform. The European consumer centre of Croatia is part of the European consumer centre network (ECC-Net), which gives advice and provides information about cross-border shopping and helps consumers in cooperation with other European consumer centres in addressing cross-border complaints and disputes. ZOARPS regulated the obligation to retailers based in the Republic of Croatia who commit themselves, or are required by relevant regulations to resolve consumer disputes through bodies for resolving consumer disputes Alternatively to inform consumers about this fact. The notice must be highlighted in a way that is clear, understandable and readily available to the consumer, on the website and in the business premises of the trader, as well as in other ways provided for special regulations on the protection of the consumer.

4. CONCLUSION

Consumers and merchants are not yet sufficiently familiar with exsisting extrajudicial mechanisms of legal protection, and only a small percentage of citizens know how to make a complaint to the authority for an alternative resolution of consumer disputes. “A significant portion - about twenty percent - of consumers experience problems in connection with cross-border purchases of goods and services within the EU.” (Bogdan, 2015, p. 155).

Alternative resolving consumer disputes, at the EU level regulated by Directive 2013/11/EU of the European Parliament and of the Council and the respective Regulation 524/2013 about online solving consumer disputes, offers the possibility of a simple, effective, fast (Wrbka, 2015, p. 94) and cheap, an out-of-court, online resolution of disputes between consumers and traders, and also contributes to the release of the burden off the overloaded courts and also better protection of consumers. However, these are not the only advantages of alternative ways of resolving consumer disputes. Among other things, in comparison to a "classic case" of dispute resolution, it gives parties the possibility of greater control over the process, as well as the greater amount of decision making (Cortes, 2011, p. 57). Alternative resolving consumer disputes via ADR/ODR could save billions of euros on a yearly basis, and further stimulate a stagnant Internal Market (European Commission staff working paper, Impact Assessment, SEC (2011) 1408 final, p. 7). The body for an alternative resolution of consumer disputes should, among other things, fill out a uniform criteria in terms of quality of alternative resolution of consumer disputes which are valid across the European Union, such as for example: independence, impartiality, speed of action**,** economy of procedure. The recent adoption of the law on alternative resolving consumer disputes apply to Croatia's consumers the same criteria. The law governs alternative resolution of domestic and cross-border disputes arising from the contract of sale or a contract of services between traders based in the Republic of Croatia and the consumer residing in the European Union in the process in front of the bodies for resolving consumer disputes alternative, which are authorized to conduct mediation or bring non-binding or binding decision. With, hopefully, fast establishment of all the needy mechanisms of the implementation of this legal text in practice, the Croatian consumers will receive the possibility of simpler and cheaper solutions of domestic and cross-border disputes. It will, perhaps, boost the confidence of Croatian consumers in the EU unique digital market and in such a way as to bridge the barriers to finding solutions to disputes arising out of online transactions, and merchants to encourage the improvement of delivery and delivery of goods, extension of the offer and strengthening the level of respect for the rights of consumers to be more secure. Finally, let’s not forget, a satisfied consumer is the initiator and the guarantee of a stronger economic development.

LITERATURE:

1. Blake, S. Browne, J. Sime, S., A Practical Approach to Alternative Dispute Resolution, Oxford University Press, 2012.
2. Bogdan, M. The New EU Regulation on Online Resolution for Consumer Disputes.Masaryk University Journal of Law and Technology, 9 (1) 2015.
3. Cortes, P., Online dispute resolution for Consumers in the European union, Routledge Research in IT and E-commerce law, 2011.
4. Cortes, P., Lodder, R.A., Consumer Dispute Resolution Goes Online: Reflections on the Evolution of European Law for Out-of-Court Redress. Maastricht Journal of European and Comparative Law (MJ). 21 (1) 2014.
5. Direktiva 2013/11/EU Europskog parlamenta i Vijeća od 21. svibnja 2013. godine o alternativnom načinu rješavanju potrošačkih sporova, Službeni list Europske unije, L 165/63.
6. Direktiva 2008/52/EC Europskog parlamenta i Vijeća od 21.svibnja 2008. godine o određenim aspektima mirenja u građanskim i trgovačkim predmetima, Službeni list Europske unije, L 136/3.
7. Direktiva 2011/24/EU Europskog parlamenta i Vijeća od 9. ožujka 2011. o primjeni prava pacijenata u prekograničnoj zdravstvenoj skrbi; Službeni list Europske unije, L 088/45.
8. Direktiva 95/46/EZ Europskog parlamenta i Vijeća od 24. listopada 1995. godine o zaštiti pojedinaca u vezi s obradom osobnih podataka i o slobodnom protoku takvih podataka, Službeni list Europske unije, L 281/31.
9. European Commission staff working paper, Impact Assessment, SEC (2011) 1408 final, Retrieved 18.03.2017 from
http://www.ipex.eu/IPEXL-
WEB/dossier/document.do?code=SEC&year=2011&number=1408&extension=null
10. Europski potrošački centar Hrvatska, Retrieved 18.03.2017 from http://ecc-croatia.hr/
11. Fogh Knudsen, L. Balina, S., Alternative Dispute Resolution Systems across the European Union, Iceland and Norway, Procedia – Social and Behavioral Sciences, br. 109, 2014.
12. Hodges, C. Creutzfeld, N., Implementing the EU Consumer ADR Directive, The Foundation for Law, Justice and Society, 2013.
13. Hodges, C. Stadler, A., (ed.), Resolving mass disputes: ADR and settlement of Mass claims, Edward Elgar Publishing Limited, UK, 2013.
14. Hornle, J., Cross – border Internet Dispute Resolution. Cambridge: Cambridge University Press, 2009.
15. Hornle, J., Encouraging Online Dispute Resolution in the EU and Beyond – Keeping Costs Low or Standards High? European Law Review, 38, 2013.
16. Primjena informacijskih i komunikacijskih tehnologija (IKT) u kućanstvima i kod pojedinaca u 2016., prvi rezultati, Priopćenje Državnog zavoda za statistiku Zagreb od 5. prosinca 2016., Retrieved 17.03.2017. from http://www.dzs.hr/Hrv_Eng/publication/2016/02-03-02_01_2016.htm
17. Povelja temeljnih ljudskih prava EU, Službeni list Europske unije, C 303/1.
18. Tepeš, N., Izvansudsko rješavanje potrošačkih sporova u Hrvatskoj, Republika Hrvatska na putu prema Europskom pravosudnom području – Rješavanje trgovačkih i potrošačkih sporova, Pravni fakultet u Rijeci, Rijeka, 2009.
19. Uredba Europskog parlamenta i Vijeća 524/2013 o on-line rješavanju potrošačkih sporova, od 21. svibnja 2013.g., Službeni list Europske unije L165/1.
20. Urša, J.; Uzelac, A., Alternative Dispute Resolution for Consumer Cases: Are Divergences an Obstacle to Effective Access to Justice?, Međunarodna revija za javno pravo, br. 4, 2014.
21. Zakon o arbitraži, Narodne novine, br. 88/2001.
22. Zakon o mirenju, Narodne novine, br. 163/2003.
23. Zakon o parničnom postupku, Narodne novine, br. NN 53/91, 91/92, 58/93, 112/99, 88/01, 117/03, 88/05, 02/07, 84/08, 123/08, 57/11, 148/11, 25/13, 89/14.
24. Zakon o zaštiti potrošača, Narodne novine, br. 41/14, 110/15.
25. Zakon o alternativnom rješavanju potrošačkih sporova, Narodne novine, br. 121/16.
26. Wrbka, S., European consumer access to justice revisited, Cambridge University Press, 2015.

MIXTURE OF PROPERTIES AND LEGAL IDENTITIES IN THE CORPORATE LAW

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

A limited liability company is a legal person. From the moment of entry of the company into a court registar, its members are no longer liable with their private property for the liabilities of the company. The company is liable for its obligations with all its assets. The key feature of mixing of properties is the unlawful reduction of company assets in favor of private property of its members, while this procedure is not recorded in the ledgers of company and it is done without guid pro quo. If the members in the case of mixing assets invoke the principle of separation of company and its members in order to avoid personal liability numerous problems occur. Tha main issue is of course the fact that company creditors will not be able to collect their monetary and other claims addressed to the company since at that time the company is already insolvent. The term mixing assets, discusses the issue of whether and under which conditions members of the company are liable for its obligations, which makes an exception in the corporate law system. There is a risk that the privilege of limited liability (or no liability at all) may be abused to the detriment of company creditors and the other members who were acting more as investors in the undertaking. Such, for the company, and indirectly, for its creditors, damaging constellation has already been formed if the property of the member gets mixed with the company assets in such way that it is not any more possible to reliably determine whether they belong to the company or are these assets now with private property of its member. The circumstances where we discuss this legal institute are not entirely clear and the paper sheds some light on this very controversial issue in the company law.

Under the concept of mixing the spheres of thought to the case when, in legal terms, is no longer possible to distinguish between the company and its members as legal entities or this difference is not clear enough. This question is also discussed in the paper.

Keywords: *Mixture of properties, Liabilities of the Parties, Mixture of Identities, Piercing the Corporate Veil, Corporations*

1. INTRODUCTION

Mixture of properties as a prerequisite of liability comes under in cases of liability for piercing the corporate veil and plays an important role in the legal system of protecting creditors of corporations (capital companies, companies). Primarily, under the concept of mixture of properties, the question is whether and under which assumptions the shareholders of the company will be responsible for its liabilities. The company is responsible for its liabilities with all its assets. Thus, in principle, it is excluded the personal responsibility of shareholders for liabilities of corporations. There is a danger that the privilege of irresponsibility of a shareholder for the company's liabilities will be abused for the achievement of objectives which are contrary to the meaning and purpose of those provisions, at the expense of the creditors of the company and other shareholders of the company (Lutter, p. 248). This, for the company, and indirectly, for its creditors, damaging

construction is already formed if the shareholder's assets are mixed with the company's assets in a way that it's no longer possible to reliably determine whether certain parts of it belong to the company or they are part of its shareholders' private property (Immenga, p. 399). If the companies' property is then transferred to the shareholders, it will significantly hamper or completely disable regular collection for the creditors of the company. The company's shareholders cannot then invoke to the circumstance that, as a rule, they are not responsible for the liabilities of that company as shareholders of it and to the fact that creditors can only rely on the assets of the company. In these exceptional cases, a shareholder of the company will be liable for the obligations of the company to its creditors unlimitedly and with all of his property. The presumptions of the aforementioned liability of a shareholder, when it comes to mixture of properties, are not entirely clear.

According to Article 10, paragraph 3 of the Croatian Companies Act, the one who misuses the fact that as a shareholder of a company, he is not liable for the obligations of the company, cannot rely on that for those obligations. The same Act lists the cases when it comes to the aforementioned misuse. In these cases there is no need to prove the existence of misuse which is otherwise required (Barbić, p. 296). Such a case would be if a shareholder of the Company:

A) uses the company to achieve a goal that would otherwise be prohibited to him,

b) uses the company to damage the creditors,

C) breaching the law, manages the assets of the company as if it were owned by him personally and

D) in his or her benefit or in favour of another person, diminishes the assets of the company, even though he knew or ought to have known that the company would not be able to fulfil its obligations.

2. INDICATORS FOR MIXTURE OF PROPERTIES

A company acquires legal personality by registering in a court registry and loses it by deleting the company from that registry (Raiser, p. 639). It can acquire rights and accept obligations, also it can be the owner of real and personal property and may sue and be sued before the state or the chosen court and participate in other proceedings. Company assets are separate from the assets of its shareholders (the principle of separation of company from its shareholders). Responsibility for piercing the corporate veil is a legal construction where, in a concrete case, the principle of separation of a company and a shareholder is neglected in such a way that the creditors of a company are authorized to engage in the private property of a shareholder of the company (without the existence of a particular foundation of shareholders' liability towards creditors, e.g. a shareholder guarantee to the creditors for the company's liabilities). Therefore, piercing the corporate veil is not a negation of the principle of irresponsibility of shareholders of corporations for their obligations, but an exception to the principle, which can in special circumstances be ignored. Accordingly, a shareholder of the company shall, if piercing is allowed, be responsible with his private assets (property) along with the company for the obligations of that company to its creditors (Schmidt, p. 241).

Responsibility for piercing is regulated in our law by the Companies Act, but even if that weren't the case, such a responsibility would derive from the purpose and meaning of its provisions as well as from two principles of the Civil Obligations Act - the principle of good faith and the principle of prohibition of abuse of rights. When shareholders are liable for the company's obligations, it can be responsible for their own and other people's obligations. If the assumptions of piercing the corporate veil have been fulfilled, it is the responsibility of the shareholders for the other's obligations-obligations of the company (Drax, p. 7). Such liability of a shareholder can occur even in one-shareholder limited liability companies. All in all, responsibility for the breach in which shareholders correspond with their private assets for

the liabilities of the company is not a regular remedy to protect creditors but it is an exception to the principle of separation that cannot be easily bypassed (Raiser, p. 640).

Mixture of properties will lead to liability for breach if it is ignored the principle of separation and the company's assets mixed with the shareholder's assets in such a way that from the accounting records of the company it is no longer possible to establish if a particular property object belonged to the company or a shareholder (Grunewald, p. 374). Therefore, the first factor of responsibility is the fact that there has been a mixture of properties. Whilst the assets aforementioned were clearly separated, there is no mixture of properties that is the factual assumption of liability for the piercing. Furthermore, the occurrence of the transfer of the company's assets (the withdrawal of funds from the company) which becomes part of the private property of a shareholder, and vice versa, is the case when the property of the shareholder becomes the property of the company (which is a much less common case). When mixing a company's and a shareholder's assets, it is typical that there is no record of the actual transfer of assets or the bookkeeping of the company is generally misleading. Such circumstances can be vividly described so that the shareholders treat the company as any part of their private property, and don't differ between their own property and the company's assets (Wiedemann, p. 224).

Vertical mixture is the mixture of properties between the company and shareholders as well as between mother and daughter companies. Horizontal mixture of properties occurs when it is not possible to separate the property of two sister companies.

The term mixture of spheres refers to the case when, in legal terms, it is no longer possible to distinguish between the company and its shareholders as legal entities or the difference is not clear enough. This is particularly evident in the company's relations with third parties. As with the mixture of properties, shareholders do not respect the independence of the company as a legal entity in relation to its shareholders. Among the mentioned groups mixture of properties there are key differences. They are reflected in the fact that the mixture of spheres is not about mixing assets but legal entities. Such a mixture of spheres occurs if several companies operate in the same business premises, with the same phone and have the same employees and similar names (Grigoleit, p. 230). Mixture of properties is one of the cases of liability for breach, while the mixture of spheres is a question of representation of the company in legal matters (to third parties). The capital question is who is represented by the person who leads the company's business, if that person is at the same time authorized to represent two different legal entities. In that case it is necessary to establish who is actually the contracting party, and thus the subject of responsibility for obligations because the statement of will can be given in one's own name and on behalf of someone else (Drax, p. 56). It follows that the mixture of spheres is not a case of extending the company's obligation to a shareholder, but it is a special basis for the liability of the shareholder for his own obligations.

3. CONSTITUENT FACTS OF MIXTURE OF PROPERTY

It is necessary to establish under which assumptions does the mixture of properties of a company with the property of a shareholder lead to the shareholder's liability on the basis of piercing the corporate veil. The legal provision on piercing the corporate veil stipulates that anyone who misuse the circumstance that as a shareholder of a company he is not liable for the obligations of the company cannot invoke to the fact that it does not comply with these obligations by law and lists cases where the presumptions of responsibility of the company's shareholder/s are considered to be fulfilled. There are no legal provisions on which facts must arise to lead to liability due to mixture of properties neither it is fully explained in the literature. According to the most common description of the mixture of properties, such mixture arises if it is no longer apparent from the accounting books whether a certain

property belongs to a shareholder or to the company. Such a position is not sufficiently clear nor is it precise enough. On the one hand, it is unclear what facts need to arise in order for a shareholder of the company to respond to the mixture of properties. On the other hand, it is necessary to establish the significance of the circumstance that the bookkeeping of the company is untidy. In addition to this, the legal effect is the equalization of the proceeds of the company's withdrawal of funds and the case of reverse mixture when the goods of the company are mixed with the property of the shareholder which is transferred to the company's assets. In both cases, it is no longer possible to determine to whom belongs a particular property, to the company or to the shareholder.

From this it can be concluded that the mixture of properties occurs also by blurring the boundaries between these assets. Parts of the property are mixed if there is no clear separation between the company's assets and the private property of a shareholder, regardless of the cause for that condition. With the aforementioned factor, the bookkeeping of the company is of great importance and if it is untidy, it can be crucial to the occurrence of mixture of properties.

Between the company and the shareholders there are two distinct assets separations - specific and bookkeeping separation. According to the specific circumstances of the case, it is concluded that the mixture of properties occurs if the assets of the company are actually (specifically) mixed with the property of the shareholder. While shareholders keep their own property separate from the property of the company, the assumptions for the mixture of properties did not materialize. Only if some of the property is transferred to the property of the shareholders and it is no longer possible to distinguish them from that property, there is a mixing effect. Therefore, even the specific (actual) blurring of the separation between the property of a company and of a shareholder results in the mixture of properties that might be a presumption for the piercing of the corporate veil. However, it is questionable whether the absence of a real separation can be a feature of mixture of properties. Some authors are of the opinion that certain material objects are not necessary to really delineate because it is not from the structure of the company, or from the provisions about the company's headquarters and provisions about the relations of the company's property with the aim of the company, cannot conclude that the company property must be located in one place (Drax, p. 88). This position can only be partially followed and, in this connection, it is necessary to analyze the provisions of the Companies Act regulating the entry and maintenance of the corporations share capital, since the question is how the company acquires ownership and other real property rights.

Under the provisions regarding capital investments, the founders may enter capital investments in money, goods and rights. Capital investments must be paid so that the company can freely dispose with them. The capital investment into a company in goods and rights must be entered in the entirety before the company is registered in the court registry. It is necessary to examine the relationship between the presumption of the existence of a concrete (real) demarcation of property and the principle of free disposal of the company with its capital investment. Specifically, it is necessary to ascertain whether the legal presumption of free disposal of company property is fulfilled if it is not clearly separated from the private property of a shareholder.

The purpose of these provisions is to ensure the irrevocable input of a capital investment so that the company can freely dispose with it, but it does not necessarily mean that the management can dispose of it freely (for example, the disposal must be approved by the assembly of the company). If the capital investment is factually and irrevocably entered into the company, the presumption of free disposal property is fulfilled. The procedure for entry of capital has thus ended. Therefore, unrestricted free disposal of the investments entered assumes that the capital investments cease to be part of the founder's property and become

unconditionally part of the assets of the company. Only the management of a company may, without limitation, dispose with the assets of the company for the purposes and fulfilment of its business objectives. If the shareholders have not irrevocably paid investments in the company, but have reserved their right to a refund, the presumption of free disposal is not fulfilled. The same applies if the capital investment of a shareholder is subject to a condition. In conclusion, the principle of free disposal is fulfilled if a company through management freely disposes of the company's property. If the capital investment is still disposed by the founders as their private property, then the property cannot be freely disposed by the management, which leads that the court registry will refuse to register the company in the court registry.

It is still necessary to clarify whether there is a real separation of assets if the company acquired ownership over the investment in goods but does not have direct possession; for example, if a shareholder pledged to enter a machine as a capital investment in goods in the company and concludes a lease with the company at the same time (and takes over the obligation to pay the monthly lease to the company). Then the owner of the machine becomes the company while the shareholder is only the direct possessor. Although it may be concluded that there is no real separation of their property, it still exists. Moreover, it is not necessary for a shareholder to deliver the machine to the headquarters of the company and hand it over to the management of the company who will hand it over back to him on the basis of the lease agreement. It is sufficient that the machine, together with the according technical data, is included in the articles of association as the capital investment of the shareholder. If both parties agree that the machine represents a capital investment in goods, it is the delimited property of the company in relation to the private property of a shareholder. Subsequently the subject may (physically) remain in the possession of the shareholder. Whilst it is clear from the articles of association and the lease agreement that the machine belongs to the company, there is no mixture of property between the company and the shareholder. It is important that there is a legal basis on which the machine is in the possession of a shareholder (lease contract). There isn't a provision which stipulates that the assets of a company must be located in one place, for example in the headquarters of the company or in its production facility. It is important that the object of the investment has irreversibly ceased to be part of the property of the shareholder and has become part of the company's property.

The provisions on the maintenance of share capital are also closely associated with the presumption of a specific (real) separation of the company's asset and the shareholder's property. For example, this is evident through the provisions of Art. 216, 217 and 224 of the CCA (for a joint stock company) and Art. 398, 406 and 407 of the CCA (for a limited liability company). Creditors can use the provisions on unauthorized earnings. Such a possibility is cited for the creditors of a joint stock company in Art. 224, paragraph 2 of the CCA, and for the creditors of a limited liability company derives from the circumstance that the application towards the shareholders on the basis of unauthorized earnings can be freely disposed of by the company so it can also be relinquished to its creditors. If the shareholders earnings are received as dividends, obligations to return those earnings exists only if they prove that the company knew or should have known that they had no right to receive the payment (v. Art. 224 no. 1st CCA). The provision of Art. 407, para. 2 of the CCA stipulates otherwise. According to this provision, a shareholder of the company can keep his earnings on the basis of profit sharing if it is received in good faith except to the extent that is necessary to settle the creditors of the company. This means that a company can request a refund from the shareholder if it is necessary to settle the creditor, regardless of whether the shareholder has received a payment in good faith. The separation of these assets is a presumption for the legal action of share capital maintenance provisions (Drax, p. 89). In

contrast, the literature doesn't consider that a specific property separation of property of the company and of its' shareholders, is a necessary presumption of the mentioned principle. As the main argument for this view, the authors point out the provisions on unauthorized earnings that do not protect specific property objects, but only part of the property necessary for the preservation of the capital of the company established by the articles of association. There is no doubt that the aforementioned provision protects the capital of the company and all other assets of the company in excess of the said amount can be transferred to the private property of its' shareholders at their discretion. Only if the transfer enters into the protected part of the company's assets (that part of the asset that corresponds to the amount of the share capital) the shareholder is obliged to repay the funds to the company. In addition, any material transactions between the company and shareholders must be in chronological order recorded in the financial records of the company so that it is possible to determine the value of the company's assets at any time and check whether the capital investment of the company is preserved. This rule is valid regardless of which part of the property it is, and not just for the share capital of the company. Therefore, the (proper) accounting of the company serves to find out if a shareholder took something from the company's assets and how the withdrawal of funds affected the protected part of the company's assets. If the accounting of the company is untidy, its assets remain separate from the shareholder's assets, assuming that the shareholder has not taken any property from the company. Only if parts of the company's assets were transferred to the private property of the shareholder, there was an interference that resulted in a mixture of properties and the provisions on capital maintenance aren't applicable (Rowedder; Schmidt-Leithoff, p. 574). Then a shareholder could lose the privilege of irresponsibility, and he would also be responsible for the company's obligations. It can be concluded that the provisions on the maintenance of capital do not regulate that objects that make up the entirety of assets should be concentrated in the company, but the principle of separation of assets should not be ignored. Alternatively, capital maintenance provisions have no legal effect if the assets of the company are not separate from the assets of its shareholders. Such a result will not arise if it is apparent from the financial records that the property of the company is transferred to the private property of the shareholder.

Actual separation of assets under the regulations in force must exist, so it is justified to consider that there was a mixture of properties when such a separation no longer existed. Therefore, the Supreme Court of Germany in its judgments calls for a real (rather than an abstract) separation of property. A lawsuit against a shareholder who has caused such a condition will only be adopted if it is a general (comprehensive) and irreversible interference. If the mixture of properties is temporary and can be eliminated by reconstructing the data from the company's financial records, it is not yet a presumption for piercing the corporate veil.

The occurrence of mixture of properties does not mean automatically that a shareholder cannot invoke the privilege of irresponsibility and that he will personally be responsible for the company's obligations. Another presumption must be fulfilled for the liability of a shareholder of the company: the circumstance that the company has insufficient assets due to these measures and cannot fulfil its obligations towards the creditors.

First, it is necessary to examine the legal effect of the circumstance that, due to the withdrawal of assets from the company, the remaining assets have become evidently insufficient to settle its' creditors claims. If the company still has sufficient assets over which an enforcement can be executed, neglecting the privilege of irresponsibility is not necessary and the creditors are not authorized to do so. Only if the company does not have enough assets so that creditors cannot be fully settled, can shareholders be responsible for liabilities of the company. In addition, it is necessary that the mixture of properties is caused by the

withdrawal of the assets which has led to the company being unable to settle its obligations so that creditors cannot be settled. If a company is left without assets or is insolvent, not because of the mixture of properties, but because of other circumstances (for example, wrong management decisions or unfavourable market conditions or unexpected bankruptcy of an important client), the privilege of irresponsibility of a shareholder of the company's obligations remains valid. Responsibility for piercing the corporate veil occurs if the company is left without property and that loss is the direct consequence of mixture of properties between the company and the shareholder.

Responsibility for piercing the corporate veil is not a regular legal remedy for the protection of the interests of the company, other shareholders, or above all the creditors of the company. It is only filling the legal gap left in the wake of regular legal remedies. As long as the protection of the interests of these subjects can be achieved by other legal means provided for by law, there is no place for this type of responsibility. When a mixture of properties occurs, if other legal actions do not provide the creditors of the company with sufficient protection, the shareholders could take away the privilege of irresponsibility for the company's obligations and they could directly be liable for the company's obligations.

Therefore, we should examine if the aforesaid protecting means provide sufficient protection in case of mixture of properties. Such a protective clause is primarily about unauthorized earnings (payments) because the withdrawal of funds is closely associated to unauthorized payments which are arranged in the provisions mentioned above. A debtor is a shareholder of a company that has received an unauthorized payment. The right to request of a shareholder to whom something has been paid belongs to the company, but can be taken over by the creditors of the company and request the settlement of the company's obligations from the shareholders of the company indirectly (Barbić, p. 1246). The company may dispose of the request, it may give transfer it to another, pledge on a fiduciary basis for the purpose of settlement. Individual detractions of the company's asset do not lead to liability for pierce, but shareholders are required to pay back what they have acquired contrary to the provisions for maintenance of the share capital. It is necessary to examine whether it would be equally effective to protect the interests of the company's creditors if the claims on the title of unauthorized income are claimed if the payment from the protected property of the company fulfils the presumptions for mixture of properties. The detractions of a company's property is similar to unauthorized payments. It differs only in the fact that unauthorized payment is recorded in the financial records while the detractions of the company's property is not recorded there. They share the fact that the part of the asset of the company has been transferred into the private property of a shareholder, thereby reducing the assets of the company. The decisive question is whether the protected property of the company has been reduced due to the private detractions of property. The assets of a company that exceed the amount of the share capital are available to the shareholders of the company. If the private detractions of property will not affect the assets of the company which are used to pay creditors, it will not activate the protective provisions of maintenance of capital. Thus, the detractions of property should occupy the protected part of the company's property. This presumption of pierce is especially met in the circumstance that a company cannot settle its obligations is a direct consequence of the withdrawal of funds from the company. If detractions of property leads to the fact that it is no longer possible to determine what belongs to a company and what to a shareholder, and if the company becomes insolvent, it is a sure indicator that the assets taken away are necessary to preserve the company.

Despite the above claim, it is dubious whether creditors can take over the company's request and seek settlement of their claims. To highlight this requirement it must be clear who has taken away and what company's asset. In the case of mixture of properties, the bookkeeping is usually untidy and it is impossible to determine when, how and which part of the asset is

returned to the shareholder and what is the property of the company is in the moment of detraction of the property. If this cannot be established, the claim for the refund of the unauthorized payments cannot be claimed. Therefore, the creditors of the company cannot successfully claim a refund of unauthorized payments, because it is unclear on which detraction of property does the claim refer to due to untidy bookkeeping. In that way the claims of the company's creditors cannot be settled. The Supreme Court of Germany in its judgments repeatedly states that the provisions on unauthorized payments will apply only in the case of individual payments from company assets that are visible if the accounting of the company is tidy.

In the case of mixture, the bookkeeping was not conducted according to the regulations so it is not possible to determine exactly what was deducted from the property of the company and which harmful consequences could have been caused by such a measure. According to the general principles of civil procedure, the plaintiff submits a request and is burdened with the evidence that the shareholder is responsible for the mixture of properties. In the concrete case of mixture of properties, the burden of claiming evidence is related to the disruption of the bookkeeping and to the fact that the shareholders actually extracted funds from the company as well as evidence of the bankruptcy. Furthermore, the plaintiff must prove that it is no longer possible to return the transferred funds (received payments) to the company. The evidence of untidy bookkeeping should not be too hard for the creditors of the company even if they don't have insight into the details of the company's business. But, upon a court order, the company is obliged to provide the prosecutor with insight into its' financial records to determine whether there are facts of relevance for the court proceedings (Baumbach; Hopt, p. 963). The court shall decide on the tidiness of bookkeeping in its discretion, but will usually use the services of an expert.The creditor must prove that the company is left with no assets and that there is a reason for bankruptcy, which is not difficult. Namely, as long as the demands of the company's creditors cannot be settled, the company is insolvent. Then the creditors of the company can file a motion to open bankruptcy proceedings. While deciding if the motion to open bankruptcy proceedings is justified, it shall be determined whether the company still has sufficient assets to settle its obligations or is it heading to bankruptcy. Even from an unsuccessful attempt to execute the enforcement of a company's property, it can conclude that the company is without property. Creditors should easily not prove the circumstance that it is not possible to refund the received (illegal) payments. Namely, due to untidy bookkeeping, there are no applicable capital maintenance provisions. They must also prove that the shareholders withdrew funds from the company and prove a causal link between the mixture of properties and the inability of the company to meet its obligations. The creditors of the company must prove in their claim that the transfer of the assets of the company required to settle all the liabilities of the company has occurred and that the company has not received (appropriate) counterparts of the company shareholder. It should not be forgotten that a shareholder has misused the circumstance that he or she is not responsible for the company's obligations because it has reduced the property of the company for his own benefit or for the benefit of another person. Therefore, there is no place for the application of the provisions of art. 407, para. 1 of the CCA (unauthorized earnings), which does not allow payments to shareholders of the company, the value of which corresponds to the amount of the share capital, since the shareholder would then only correspond to this reduced amount which is not sufficient to settle the creditor of the company. In addition, creditors must prove that due to the transfer of assets to a shareholder of the company they cannot settle their obligations. Unlike other factual assumptions about the mixture of properties, creditors will hardly prove the existence of those facts. The company's creditors will not easily prove that the shareholder has not given an adequate diligence and that this circumstance has caused the company to fail to meet its obligations. External creditors of the

company, unlike the company's shareholders, have no insight into the property and legal relations of the company and its shareholders. In bankruptcy proceedings or regular court proceedings, the creditor, according to the court order, has unrestricted access to financial records and bookkeeping documents of the sued company. This insight into the books of the company does not facilitate the burden of proof for the creditors because in the case of mixture of properties, the company or a shareholder did not properly conduct the accounting. It is therefore difficult for the creditors of the company to prove that the shareholders of the company have subtracted parts of the company's assets that are required to settle the company's obligations and that because of that action the company cannot settle its obligations. Because of the difficulty of proving, it would be reasonable to switch the burden of proof from the creditors to the shareholders of the company (Roth; Altmeppen, p. 340). It is dubious whether there is a legal basis for such a transfer of the burden of proof. When the defendant can not substantiate his claims, the burden of proof will be eased if there are additional facts. If these presumptions are met even in the case of mixture of properties, there are no barriers towards facilitating the burden of proof for the creditors of the company. The claimant can ease the burden of proof if he disposes of additional indicators that the subsidiary is damaged by measures from the parent company. Applying this claim to the case of mixture of properties, it is concluded that the circumstance of the existence of untidy bookkeeping is still not sufficient to justify the easing of the burden of proof. It is only possible for the creditor to ease the burden of proof, when it provides additional evidence of the existence of facts, suggesting that due to a shareholder's involvement in the company's asset it cannot meet its obligations. One of these indicators is proof of the transfer of the company's property to a shareholder. For example, creditors may invoke the statement of a member of the board (who is not a shareholder of the company). The circumstance that a company's property has been transferred to a private property of a shareholder, would be additional proof as the assets of the company were reduced, which could have caused the excessive debt or inability to pay for the company, or to deepen the already created crisis of the company. If the creditor proves that such a transfer of the company's assets has occurred, then the shareholder of the company must further clarify that he has made the company an appropriate consideration or that his involvement in the company's assets is not jeopardized by the funds necessary to maintain the assets corresponding to the amount of the share capital of the company. The transfer of the burden of proof will be allowed if the creditors of the company demonstrate the existence of additional facts. The defendant, unlike the creditor of the company, has an insight into the company's business and it is justified that he must further clarify the circumstances of the company's withdrawal and must prove that this measure did not lead to the company being unable to meet its obligations. In order to ease the burden of proof to creditors, they should prove that the accounting of the company is untidy. They cannot usually prove that because of a shareholder's intervention in the company's assets, they cannot settle their obligations and are in a less favourable position than the creditors of a subsidiary regarding a qualified factual concern that is suing the parent company. The creditors of the subsidiary cannot separate the individual harmful measures and their effect on the subsidiary because the parent company exercises its influence on the subsidiary comprehensively and continuously. If the accounting of these companies is also untidy, the creditors cannot really prove that an individual measure has led to the company's failure. A qualified factual concern exists when the power of subjecting the management of the subsidiary is resulting from the position of the parent company in relation to the subsidiary on the basis of regulation between the companies or by using the influence of the parent company to engage in the business of the subsidiary as would be the case the existence of the contract on managing business operations. Its' adverse effects impact the parent company with its width, intensity and duration are not just

individual, but decisively engage in the entrepreneurial structure of the subsidiary. The consequence of this is to apply protective measures as it is a contract of managing business operations, which provides an obligation to cover the losses of the subsidiary (Art. 489 of the Act), to protect the creditors (Art. 490 of the Act), to pay the appropriate compensation (Art. 491. Act) and appropriate severance pay (Art. 492 of the Act), and the claims for damages to persons representing the parent company under the law (Art. 494) and the members of the management and supervisory board of the subsidiary (Art. 495). Harmful effects of these measures must be compensated by the end of the financial year in which the measure was taken so that it can be published in the annual financial statements. Therefore, the subsidiary company has no claim to the parent company to obtain the proper benefits for the duration of the business year in which, under his influence, it has taken a harmful measure. If the parent company does not obtain to the dependent company corresponding benefit by the end of that financial year, it shall provide to it a legal requirement for it to be obtaining a precise benefit both to determine what will it give and that her value. This must be done by contract, and at the latest by the end of the financial year in order to request not to show in the annual accounts and that this would be subject to examination of auditors. For it is not enough one-sided statement of the parent company (Barbić, p. 633).

Unlike the creditors of the company, a shareholder, as a rule can prove that there was no transfer of parts of the company's assets in his property. He is required to know whether a property objects belonging to the company switched to his private property and whether he made an appropriate to the company for it. If a shareholder is also a board shareholder, he must know whether that measure took a piece of property that serves to the maintenance of assets corresponding to the amount of share capital and whether there is (except the mixture of properties) another cause of the collapse of the company. In addition, shareholders are normally obliged to monitor the management, and in particular to control if the management tidily keeps its' books which speaks in favour of easing the burden of proof to the creditor of the company (Schmidt, p. 2650). The shareholders are jointly responsible for untidy bookkeeping. They must prove that they have not transferred funds from the company to their private property. If they do not, they are personally liable for the company's debts.

4. CONCLUSION

Mixture of properties is considered one of the most important cases of liability for a pierce. In literature, as in the case law, it is an almost unique position that the company's shareholders are liable for the company's obligations of in the case of mixture of properties. However, many details, such as factual presumption of responsibility and legal liability effects are not fully clarified either in literature or in case law. Liability for the pierce is an extension of liability of the company to its' shareholders. This liability represents an exception to the limitation of liability that is typical of a corporation. The limitation lies in the fact that the company's shareholders are generally not liable for the obligations of the company. Undercapitalization, the liability of the parent company in the concern (dominance) and mixture of properties are the exceptions to the rule described. Mixture of properties that leads to pierce emerges only when company shareholders obtain assets from the company, and the bookkeeping of the company is untidy. This results in the specific and accounting mixture of properties. Then it is not possible to reconstruct the boundary between the company' assets and the shareholder's property. Therefore, the deprivation of company assets and untidy bookkeeping are factors of liability for mixture of properties that must exist simultaneously. If company is detracted property objects that can be extracted and identified, that will represent unauthorized payments regulated by Article 224 and 407 of the Companies Act. A shareholder could be responsible for the return of received payments in the event when the accounting of the company is untidy but the circumstance that a shareholder was

paid from the assets of the company can be proved otherwise. The fact of mixture of properties does not in itself lead to the conclusion that shareholders are responsible for the pierce. Intervention by pierce depends on the fact that the company cannot fulfil obligations to its creditors as a result of mixture of properties. As long as the company has sufficient assets to settle the creditors of the company, there are no regulations that give grounds to the creditors to request settlement directly from the shareholders of the company. An additional presumption for liability is the fact that it is no longer possible to return the received payments to the company.

Creditors must prove the fact of mixture of properties of the company with assets of the shareholder/s. The burden of proof does not apply only to the untidy bookkeeping and the fact that the shareholders withdrew funds from the company, but it must be proven that the company doesn't have enough assets for the settlement of its liabilities and that it is no longer possible to return the received unauthorized payment by the company.

Regarding the specific difficulties relating to the circumstances that proving the company's assets were pulled out of the company and that this measure endangered the company, the company's creditors should be relieved from the burden of proof if they provide additional evidence that the shareholders withdrew goods from the company. If there are facts of mixture of properties and other presumptions for pierce, all shareholders that are in any way involved are liable for the pierce. Pierce in the strict sense of the word, affects first those shareholders who, through their actions or omissions, either alone or in joint action with other shareholders meet the factual presumptions which constitute the mixture of properties. Such presumptions will usually meet a shareholder of the company who also leads the company's business. They will also be met by the shareholder who does not participate in managing the activities of the company. This will be the case if a dominant shareholder doesn't run the business of the company but through his influence in the company meets the requirements of mixture or gives instructions to the management. This also applies to the minority shareholder who is the economically dominant shareholder. Furthermore, a shareholder of the company who is confusing the goods to acquire material gain is also liable because he accepted the transfer of the company's property thereby helping the occurrence of mixture of properties. Whoever is responsible for mixture of properties has unlimited liability to the company. If several shareholders met the presumptions of liability, they are liable jointly and solidarily. The provision of Art 10 para.3 point 4 of the Companies Act according to which the shareholder is abusing the fact that as a shareholder of the company, he is not liable for obligations if in its favour or in favour of any other person he reduces the company's assets, even though he knew or should have known that it would not be able to settle its credits.

LITERATURE:

1. Altmeppen, H.; Roth, G. (2003). Gesetz betreffend die Gesellschaften mit beschränkter Haftung. Kommentar. 4th Edition. München:C.H. Beck.
2. Barbić, J. (2005). Pravo društava. Društva kapitala. 3rd Edition. Zagreb: Organizator.
3. Barbić, J. (2006). Pravo društava. Opći dio. 2nd Edition. Zagreb: Organizator.
4. Baumbach, A.; Hopt, K. J. (2003). Handelsgesetzbuch: Mit Gmbh and Co., recht der allgemeinen Geschäftsbedingungen und Handelsklauseln, Bank- und Börsenrecht, Transportrecht (ohne Seerecht). München: C.H. Beck.
5. Drax, M. (1992). Durchgriffs- und Konzernhaftung der GmbH-Gesellschafter: ein Vergleich. München: WF.
6. Scholz, F.; Emmerich V. (2000). Kommentar zum GmbH-Gesetz, 9th Edition. Köln: Otto Schmidt.
7. Grigoleit, H. C. (2006), Gesellschafterhaftung für interne Einflußnahme im Recht der GmbH. München: C.H. Beck.

8. Grunewald, B. (2002). Gesellschaftsrecht. 5th Edition. Tübingen: Mohr.
9. Immenga, U.(1970). Die personalistische Kapitalgesellschaft:eine rechtsvergleichende Untersuchung nach deutschem GmbH-Recht und dem Recht der Corporations in der Vereinigten. Bad Homburg: Athenäum.
10. Raiser, T.; Veil, R. (2001). Recht der Kapitalgesellschaften. 3rd Edition. München: Vahlen.
11. Rowedder, H.; Schmidt-Leithoff, C. (2002). Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG): Kommentar. München:C.H. Beck.
12. Schmidt, K. (2002). Gesellschaftsrecht, 4th Edition. Köln: Carl Heymanns.
13. Wiedemann, H. (1980). Gesellschaftsrecht. Band 1 (Grundlagen). München C.H. Beck.

LEGAL UNCERTAINTY AS NUISANCE TO INVESTMENT PROCESS IN RENEWABLE ENERGY

Nevena Aljinovic
University Department of Forensic Science, University in Split
nevena.aljinovic@gmail.com

ABSTRACT

With a goal of harmonizing its legislation with the EU acquis, Croatia had to reform its own judicial system. The reform of the energy sector has began with adoption of the first package of energy legislation that the Croatian Parliament has brought in 2001. Five law Acts were adopted regulating the area of energy, gas and petroleum products. For Croatian legal system that was a novelty, since the subject matter previously was governed by many regulations of various legal areas, not laws, so in the coming years there were frequent and numerous amendments on adopted laws. All this led to legal uncertainty not only for potential, but also for current investors who had to dealt with the uncertainty of the legal system for years, in order to realise the project which they had already started. The intention of this paper is to present the complexity of the energy sector reform, which may result with legal uncertainty for project realization in renewable energy sources. On the example of Acciona Energy company, I will show a fraction of they legal path in realizing project to build one of the largest wind farms in Croatia on the Jelinak hill and to offer some conclusions.

Keywords:, *Acciona Energy, energy packages ,energy sector, reform of energy sector, wind farm*

1. INTRODUCTION

In order to understand the reasons for the frequent amendments to the laws passed in the energy sector, and the difficulties in realizing the Jelinek wind farm project it is necessary to understand the legal path of harmonization of Croatian legislation with the EU acquis regarding the energy packages. The Republic of Croatia has pledged to comply its legislation with energy packages of the European Union, till accession to full-fledged membership. Until the energy reforms began, in the Republic of Croatia there was no legal or sub-legal framework for legal regulation of this subject matter. This area was regulated by special regulations of various legal areas. Reform of energy sector led to the radical intervention and put Republic of Croatia to great challenges. It was unrealistic to expect that this kind of work, in such complex matter such is reform of energy sector, could be harmonized with EU acquis in the period shorter than it was done. The European Union, through its energy policy, promotes the importance of renewable energy sources. The challenges facing Europe in the area of energy include issues such as the growing dependence on imports, high and unstable energy prices, rising global energy demand, the need for greater transparency and the interconnection of the energy market. The cornerstone of European energy policy is a variety of measures aimed at establishing an integrated energy market, security of energy supply and energy sector sustainability. In order to harmonize and liberalize the internal energy market of the European Union, three consecutive legislative packages of measures have been adopted from 1996 to 2009.[1] Energy laws are changing in oreder to establish a common energy market in the European Union where the same rules apply to all who participate in it.

[1] The first package of energy legislation was passed in 1996 and 1998, The second package of energy legislation was adopted in 2003 and the third one in 2009.

The Republic of Croatia has pledged to implement in domestic energy legislation the 3rd EU package till accession to full-fledged membership to EU. This means transferring the guidelines of the directive into a Croatian Energy Laws packages. As the three energy packages in the EU are made successively, so are the changes in the energy sector in the Republic of Croatia made to. In order to access to the European Union, Croatian legislation had to be aligned with the EU acquis, regarding the EU Directives and Recommendations. The intensive normative activity of the energy sector started in 2001 and has been going on in stages until today.

2. HISTORICAL SUMMARY OF ENERGY PACKAGES OF THE EUROPEAN UNION

The EU's **"First Energy Package"** is Directive 96/92 / EC concerning common rules for the internal market in electricity and Directive 98/30 / EC 1998 concerning common rules for the internal market in natural gas.[2] These are the rules applicable to the organization of the energy sector and for the establishment of a balance between the market and Public Service Obligation (PSO).[3]

The **"Second Energy Package"**, apart from the new directives relating to the electricity and gas markets, has been further expanded by the directives regulating the security of energy supply and investment in energy infrastructure and also with the Commission Regulations on the conditions for access to the network for cross-border exchanges of electricity and natural gas transport and includes Directive 2003/54 / EC concerning common rules for the internal market in electricity,[4] Directive 2003/55 / EC concerning common rules for the internal market in natural gas,[5] Directive 2004/67 concerning measures to safeguard security of natural gas supply,[6] Directive 2005/89 on measures to protect the security of electricity supply Energy and investment in infrastructure, Regulation EC no. 1228/2003 on conditions for access to the network for cross-border exchanges in electricity[7] and Regulation EC No. 1775/2005 on conditions for access to natural gas transmission networks.[8] Special emphasis was placed on national regulatory bodies, public service obligations and consumer protection, supervision of supply security, technical rules, new production capacity building procedures, third party access to energy system, market opening and mechanisms Cross-border energy trading.

[2] Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity (SL L 27, 30.1.1997, p. 20–29) and Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas (SL L 204, 21. 7. 1998., p. 1-12).

[3] Stupin, K., Stanje i perspektive energetskog zakonodavstva Republike Hrvatske, Zbornik radova pravnog fakulteta u Splitu, god. 52, 3/2015, str. 630.

[4] Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC (OJ L 176, 15. 7. 2003., p. 37).

[5] Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (OJ L 176, 15. 7. 2003., p. 57).

[6] Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply (SL L 127, 29. 4. 2004., p. 92-96).

[7] Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity (OJ, L 176, 15 July 2003).

[8] Regulation (EC) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks (SL L 289, 3. 11. 2005., p. 1-13).

The Commission's report from January 2007 on Energy Policy and Research of European Power and gas sectors[9] have shown that existing rules and measures do not provide a sufficient framework for achieving a functioning internal energy market.
As result of that the Third Energy Package was adopted on July 13, 2009. It was made up of two directives and three regulations[10] which introduces new rules on effective separation of production and supply from network industries; greater transparency of the supply market, wider requirements related to the implementation of public services and introduces to the energy sector the so-called " Universal service"[11] and establish a Energy Regulatory Agency, placed in Ljubljana, as an independent European institution, competent for the co-operation of national regulatory bodies and deciding on issues of cross-border energy exchange. The application of "Third Energy Package" started in 3rd March 2011.
In the second half of 2012 has began alignment of the Croatian acquis with III. EU Energy Package.

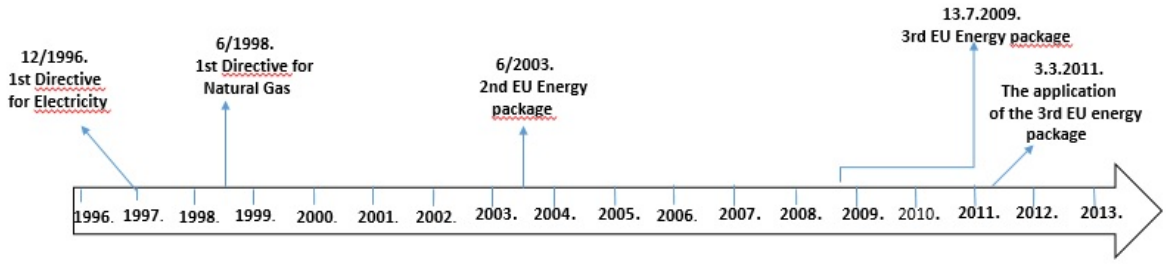


Image 1. An overview of the adoption of European Union Energy packages

3. THE COURSE OF ENERGY SECTOR REFORM IN THE REPUBLIC OF CROATIA

The reform of the energy sector in the Republic of Croatia started with the adoption of the first package of energy laws passed by the Croatian Parliament in 2001,[12] thus setting the foundations for opening the energy market in the Republic of Croatia. By adopting energy laws, the basic legislative framework for the reorganization and restructuring of the energy sector has been established. The adopted laws, which enforcement began on January the 1st 2002, have shown certain deficiencies that were primarily apparent in their application in practice, resulting in frequent amendments and supplements. The problem of implementation in practice was the fact that implementing regulations to ensure the implementation of the adopted laws had not been adopted. This is understandable taking into consideration that Croatian legislation, prior to the adoption of energy laws, did not regulate the subject matter by legal or subordinate legislation but by special regulations of different legal fields. Also,

[9] The Communication of 10 January 2007 entitled "Energy Policy for Europe"; The Communication of 10 January 2007 entitled "Prospects for the Internal Gas and Electricity Market" and "European Gas and Electricity Sector Investigation" under Article 17 of Regulation (EC) No. 1/2003 (final report).
[10] Directive 2009/72 / EC on common rules for the electricity market, Directive 2009/73 / EC on common rules for the market in natural gas, Regulation EC No. 714/2009 on the conditions for access to the network for cross-border exchanges of electricity, Regulation EC No. 715/2005 on the conditions of access to natural gas transmission networks and Regulation EC No. 713/2009 on the Establishment of the Agency for the Cooperation of Energy Regulators
[11] Universal Service is the ultimate household consumer's right to supply energy of a certain quality by clearly comparable, transparent and non-discriminatory prices.
[12] In July 2001, the Croatian Parliament adopted five new laws: Energy Act, Electricity Market Act, Oil and Oil Derivatives Market Act, Gas Market Act and the Regulation of Energy Activities Act, the so-called. "The First Package" of Energy Laws. The enforcement of these Acts began in January 1 In 2002.

the cause of numerous amendments to the Energy Laws is certainly an obligation to further align Croatian Energy legislation with the EU acquis, which was not a slight task either. In December 2004, the Croatian Parliament adopted a second package of energy laws. Implementing regulations were brought afterwards and, together with the Energy laws, a complex system of organization and operation of the energy sector was established.
But the subject matter was not always regulated in a clear and precise way which has led to difficulties in the implementation in practice. In the year of 2005, two more laws in the area of energy[13] were adopted but in the following years of 2007, 2008 and 2009. several amendments to the adopted laws were made. At that time, pursuant to the Energy Act and the Electricity Market Act, more than 30 subordinate regulations in the electricity sector were adopted. The main reasons for the adoption of the The Act on Amendments to the Electricity Market Act was the need for full harmonization with the EU Directives.[14] Numerous amendments to the energy laws have led the legislator to adopt the new Energy Act[15] and the Regulation of Energy Activities Act,[16] in 2012., which laid the foundations for the adoption of the Heat Energy Market Act,[17] and in 2013 the new Electricity market Act[18] and the Gas Market Act.[19] Until the adoption of the Renewable Energy Sources and Highly Effective Cogeneration Act,[20] renewable energy sources were regulated by numerous laws and series of implementing regulations, which cause difficulties in implementation both for project holders and for those who apply these regulations within their scope of work. The Renewable Energy Sources and Highly Effective Cogeneration Act, the Croatian Parliament passed on September 10, 2015. It is explicitly emphasized that the use of renewable energy sources is in the interest of the Republic of Croatia in the energy sector, as established by the Energy Development Strategy of the Republic of Croatia.

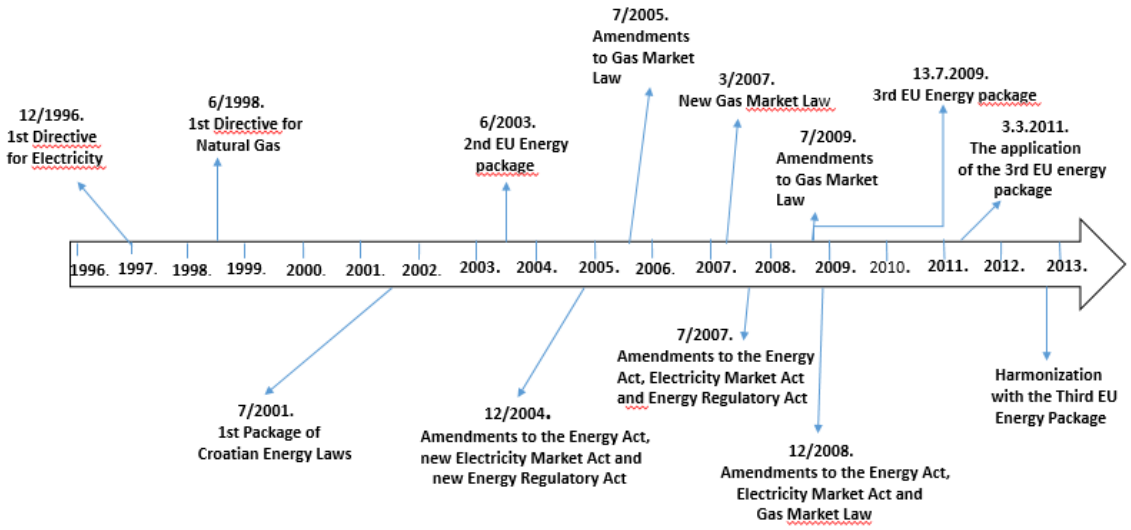


Image 2. Historical course of harmonization of energy legislation

[13] Production, Distribution and Supply of Heat Energy Act, "Official Gazette", no. 42/05 and the Act on Amendments to the Gas Market Act, "Official Gazette", no. 87/05.
[14] Directive 2003/54 / EC of the European Parliament and of the Council concering common rules for the internal market in electricity and Regulation 1228/2003 / EC of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.
[15] „Official gazette“ of the Republic of Croatia, no. 120/2012.
[16] „Official gazette“ of the Republic of Croatia, no. 120 /2012.
[17] „Official gazette“ of the Republic of Croatia, no. 80/2013
[18] „Official gazette“ of the Republic of Croatia, no. 22/2013.
[19] „Official gazette“ of the Republic of Croatia, no. 28/2013.
[20] „Official gazette“ of the Republic of Croatia, no. 100/15.

The Energy Development Strategy was adopted by the Croatian Parliament on October 16, 2009. Energy Development Strategy defines the framework objectives for Renewable Energy Sources. Considering the economic and financial crisis, economic growth forecasts and direct energy consumption have not been achieved, so the goals set out in the Energy Development Strategy had to be corrected and adjusted to the new situation and plans.[21] The strategy starts from the assumption of a stable economic growth of gross domestic product of 5% per annum, as a logical trend from previous time (2006, 2007 and 2008). As a result of the economic and financial crisis, the Gross Domestic Product (GDP) has fallen down by 21.5% in the period from 2009 to 2012 instead of, as expected, beeing increased. With the decline in industrial production and the general social standard, energy needs are also reduced. Unexpectedly well progress in renewable energy growth was not accompanied by rapid growth in demand for electricity, prompting the Government to bring in the "National Action Plan for Renewable Energy Sources by 2020" (NAP), which aimed at limiting the growth of renewable energy sources. This plan sets out a long-term perspective and a plan for the development of renewable energy infrastructure in Croatia in accordance with EU implementing measures package. Directive of the Council of Europe on the Promotion of the Use of Renewable Energy from 23 April 2009 has been fully implemented in Croatian legislation by adopting the National Renewable Energy Action Plan (NREAP) adopted by the Government on 17 October, 2013. According to the EU Directive, 35% of electricity must be produced from renewable sources by 2020, and the largest contribution should be made by wind power plants that are currently the cheapest technology for exploiting renewable energy sources. "National Action Plan for Renewable Energy Sources by 2020" (NAP) has virtually overruled the goals and measures of the Energy Development Strategy adopted by the Parliament (practically superior to the Government). The National Action Plan has set, as one of the targets for 2020, the installation of 400 MW in wind farms, which is considerably less than it was foreseen by the Energy Development Strategy.[22] Since, according to earlier state authorities' decisions, the investors had already obtained licenses and invested considerable financial resources in the developing of wind power, it was possible to realize 743 MW of wind power (instead of 400 MW as predicted by the NAP) for those investors whose contracts that have already been concluded. The Republic of Croatia aims to use renewable energy sources for 2020 in accordance with the calculation with Directive 2009/28 / EC and the Energy Climate Package. The National Action Plan for the Production of Energy from Renewable Energy Sources defines the objectives for three sectors: the Power Sector, Transport Sector and Heating and Cooling Sector. The Energy Development Strategy defined the national target of 35% of renewable energy sources in electricity consumption in 2020. The Republic of Croatia plans to achieve a defined target in renewable energy sources with domestic sources exclusively.

Figure following on the next page

[21] National Action Plan for Renewable Energy Sources by 2020, Ministry of the Economy, p. 10th

[22] Energy Development Strategy foreseen the installation of 1200 MW in wind farms, which is three times more than it is foreseen in National Action Plan for Renewable Energy Sources

4. REVIEW OF MEASURES TO ENCOURAGE THE USE OF ENERGY FROM RENEWABLE SOURCES IN THE REPUBLIC OF CROATIA

Name and measure reference	Type of measure	Expected results	Target group and/or activity	Existing or planned	Start date and completion of measure implementation
Electricity					
Encouraging the use of renewable energy sources (RES) in the production of electricity	Legal, Financial	35% of electricity production from RES in total direct electricity consumption by the end of 2020.	Carriers of development projects using RES. Preferred electricity producers	Existing	2007.-

Table 1. Encouragement measures for use of energy from renewable sources in the Republic of Croatia

From the table above, it is obvious that the use of renewable sources in electricity generation is encouraged through legal regulation and project financing. Expected results are that 35% of the electricity produced by the end of 2020, will come from renewable energy sources in total direct consumption. The implementing measures have been applied since 2007 until today. In 2007 legal framework, for encouraging the use of renewable energy sources in electricity production, was adopted and, after several years of practice, in 2012 has been amended and revised. The Ministry of Economy, Entrepreneurship and Crafts[23] (MINGO) is responsible for implementation of the program. The Croatian Energy Regulatory Agency[24] (HERA), the Croatian Energy Market Operator d.o.o., (HROTE), the Eelectricity system operators Croatian Transmission System Operator (HOPS) and Croatian Electric Power Company - Distribution System Operator d.o.o.[25] (HEP-ODS). have an important role in implementing the program, especially in terms of issuing permits, solutions and approvals. The Energy Sector and Investment Activity Monitoring Center is responsible for overseeing and removing obstacles to the implementation of renewable energy projects.

5. DEVELOPMENT OF WIND POWER IN THE REPUBLIC OF CROATIA

Republic of Croatia produces 50% of its energy needs, which means that half of its energy is imported. Reducing the import energy dependence today is one of the biggest energy policy challenges.[26] Directing and investing in renewable energy sources is certainly a challenge that Croatia should focus on. Already in the 1980s,[27] in the Republic of Croatia, satisfactory wind power has been recognized and first wind farm construction, using wind power as a renewable energy source, was built.

[23] The Ministry of Economy, Entrepreneurship and Crafts (MINGO) oversees the calculation, payment and spending of incentive fees.
[24] The Croatian Energy Regulatory Agency (HERA) has the role of monitoring the application of the tariff system and monitoring of privileged producers in meeting the conditions.
[25] HEP ODS performs electricity distribution activities: measurement tasks, consumption calculation, maintenance of the metering point and other field activities.
[26] Pupavac D., Maršani R., Pupavac J.; Prilozi promišljanju ekološke problematike u Republici Hrvatskoj, str. 259.
[27] Wind farm in Croatia started their development in 1988. by setting the first Končar wind turbine in Ugljanik.

The measurements of certain wind characteristics have shown that Adriatic region is more favorable for the exploitation of wind energy than the continental part of Croatia. Up to now, most of the wind power projects have expressed the highest interest in the areas of Zadar, Šibenik-Knin, Split-Dalmatia and Dubrovnik-Neretva Counties. Over the past 10 years wind energy has been promoted to the fastest growing industry in the world. In the last 5 years wind farms are at the very top of all the energy sources. The wind agregates have grown to almost unimaginable dimensions and have specialized in almost all types of terrain and climatic conditions and can be found in tropical areas as well as arctic conditions. The standard wind turbine dimensions doubled in 10 years, and the power increased by up to three times.[28] Using wind energy as a renewable energy source contributes to the achievement of the Republic of Croatia's energy interests, as set out in the Energy Development Strategy of the Republic of Croatia, with a special emphasis on wider use of its own natural energy resources as well as the long-term reduction of dependence on energy imports. Because the wind blowing direction is very dynamic, there must be a high power regulation availability within the power system, capable of enhance or suspending operation in times of sudden absence or increased of wind activity. The existing Croatian electric park can accept about 400 MEW wind turbines. On December 31' 2015, there was 16 wind farms in operation with two pre-construction projects, with total amounted of power of 418.25 MW. Seven wind farms were on the waiting list with all building permits issued and all Electricity purchase contracts signed.

6. ACCIONA ENERGY- PROJECT JELINAK WIND FARM

Acciona Energy is the first Spanish wind power company that has begun a wind farm building project in Croatia. It is the biggest global energy company operating exclusively in the renewable energy sector, present in over 20 countries on five continents.[29] It has more than 30,000 employees in the world's leading renewable energy sector, with 217 wind farms in 12 countries worldwide. The wind farm project in Croatia, on Jelinek Hill, worth EUR 45 million, was entirely financed by the Split company EHN d.o.o. which is part of the Spanish corporation of Acciona Energia. Although the company EHN d.o.o., was founded in 2001, until 2007 no complete legal framework for the development of wind farm technology in Croatia was provided. Preparations for Jelink wind farm construction have lasted for ten years, from which the time period 2001-2007 was spent on obtaining documentation due to then non-existent laws and subordinate acts. Jelinek Wind farm was built in the area of Marina and Seget Municipality, in Split-Dalmatia. County. At the location of Jelinak, a total of 20 wind turbines of 1.5 megawatts (MW) have been installed, so that the total installed power of the wind farm is 30 megawatts (MW). This means that the Jelinak wind farm will produce 81 million kilowatt hours (kWh) of electricity annually, which is enough to supply 30,000 households and replaces energy from 48,000 (48,000) barrels of oil annually. Approximately 60 percent of the investment involved domestic companies in the production of parts, work, transportation and assembly. The wind turbine tower 80 m high, and the wind turbine poles have built in Special building shipyard (BSO) in Brodosplit. The partner Tromont made an electrical installation in Čaporice. EHN d.o.o. has agreed with HEP for the reconstruction of the associated power grid and the construction of 110 kV substation.

The investment also encompassed the following supporting infrastructure:

• Underground installation of meddle-voltage electric power cables connecting the turbines with transformer station,

[28] http://www.vjetroelektrane.com/energija-vjetra-u-energetici?showall=1
[29] https://www.acciona.com/business-divisions/energy/

• Construction of transformer station installation of power cable connecting transformer station and the overhead power line 100 kV,
• Construction of optical wavwguide telecommunications network,
• Construction of internal service- roads a total length around 7000 m.[30]

The Location permit was issued in July 2009,[31] during the changes in energy laws as the part of the alignment process with EU second energy packages and just before the EU third energy packages was brought. At thet time the croatin Energy Act was amended for the third time. The Building Permit was issued on 03 September 2010[32] and has been changed three times in the following years. For the first time it was changed on November 24, 2011,[33] the second change was made on January 10, 2012.[34] and the third change on the Building Permit was made on April 11, 2013.[35] The second and third changes on the Bilding perimt include the period of application of the European Union 3rd Energy Package.
In March 2012, Minister of Construction and Physical Planning laid the foundation stone for the construction works for the Jelinek wind farm on the same named hill in Trogir hinterland. On that occasion investors expressed extremely dissatisfaction with the administrative procedure, pointing out that the preparatory phase of the project lasted almost 10 years. The project has been developing for almost ten years, and has gone through the trivial road of amending the spatial plans, obtaining all permits and approvals, developing the project in incomplete and undefined legal regulations, until the investment achievement.
The construction of the wind power plant lasted only a few months. The construction began in early March 2012 and was completed by the end of November 2012.
In November 2012, then President of the Republic of Croatia Ivo Josipović officially opened the wind farm Jelinak, stressing that investments in renewable energy sources are extremely important for Croatia in achieving national interests in the field of energy – reducing dependence on imports, usage of new sources that are more effective than traditional ones, reducing the use of fossil fuels, protecting the environment, developing entrepreneurship, encourageing new technology and the economy as a whole. The president has especially praised the Split-Dalmatia County for encouraging investments in renewable energy sources. For doing so it is done a lot to set the country out of the crisis. The director of the Spanish company Accione Energie for Croatia[36] pointed that investors and producers of renewable energy sources were disappointed with the proposed National Action Plan for Renewable Energy, and called on the Government of Croatia to take into account the potential of renewable energy sources that are and shoul be national interest.[37]

[30] Acciona Energy; Jelinak Wind Farm Project, Crotia, Stakeholder Engagement Plan, June 2013., p.3.
[31] Location permit for the construction of Jelinak Wind Farm, Ministry of Environmental Protection, Spatial Planning and Construction, CLASS: UP/I-350-05/09-01/3, Reg :531-06-09-19 from 21st of July 2009.
[32] Building permit, the Ministry of Construction and Spatial Planning, Class: UP/I-361-03/10-01/42, Ref :531-18-1-1-1467-10-22 from 03rd of September 2010
[33] First amendment to a Building permit, Class: UP/I-361-03/11-01/167, Ref: 531-18-1-1-1467-11-14 from 24th of November 2011.
[34] Second amendment to the Building permit, Class: UP/I-361-03/11-01/225, Ref: 531-18-1-1-1467-12-2 of 10th of January 2012.
[35] Third amendment of the Building permit, Class: UP/I-361-03/13-01/42, Ref: 531-04-1-2-1-1467-13-12 from 11th of April 2013.
[36] The director of the Spanish company Accione Energie for Croatia in 2012 was Mirko Tunjić.
[37] http://www.jutarnji.hr/vijesti/hrvatska/pokrenuta-vjetroelektrana-od-50-milijuna-eura-ali...-investitori-nazadovoljni-akcijskom-planom/896758/

7. CONCLUSION

By adopting and implementing European Union energy packages, Croatia faced a major challenge called „The energy sector reform“. For Croatia this was a big and complex step since the energy sector until the adoption of the "First Energy Package" in 2001 was not regulated by laws and subordinate acts but by special regulations of different legal areas such as concessions, municipal economy, spatial planning etc. The problem of realization of passed laws was a lack of implementing regulations, without which the adopted laws were only a black letter on paper. Numerous amendments to energy laws, that may result in legal uncertainty, are the consequence of further Croatian obligations to align energy legislation with the European union acquis. Afterwards the implementing regulations were adopted, and together with the passed laws, they established a complex system of organization and operation of the energy sector, which was sometimes unclear and unprecise. This is understandable if taken into consideration that this was the first attempt of law regulation such complex matter such is energy sector. Regardless on the slowness of the existed system in the realization of projects aimed at investments in renewable energy sources, I believe that such brakes of administrative nature will not be in the future. All necessary energy laws and implementing regulations have been adopted. The obstruction is visible only in the National Action Plan for Renewable Energy that sets quotas that limited the installed wind power capacity to total of 400 MW by 2020. However, unexpectedly good progress in the growth of renewable energy sources has not been accompanied by a rapid increase in demand for electricity. For this reason it is necessary to understand the Government's decision to reduce the installed power for wind farms from the original 1,200 MW set by the Energy Development Strategy to 400 MW set by the National Action Plan for Renewable Energy. Finally, the installed power of wind farms was set to 743 MW by 2020. because by the time Government decision to reduce the quota is made, the existing government has already issued decisions and solutions to individual investors, so for those projects that already had all the necessary permits it was decided to enable it to be realized. We must be aware that legislative framework sometimes doesn't provide adequate responses, so it is necessary to harmonize, to monitor and to adapt the legislative matter to the acquis, but also to the concrete life situations that sometimes require quick responses and reaction and do not bear the postponement. The legal system must be ready to respond on demands and minimize the sluggishness that is the brake on further investment and prosperity.

LITERATURE:

1. Acciona Energy; Jelinak Wind Farm Project, Crotia, Stakeholder Engagement Plan, June 2013.
2. Kondić V. Piškor M., Sustav upravljanja zaštitom okoliša prema normi ISO 14001 i razvoj metodologije za njenu implementaciju, ISSN 1864-6168, str.111.-118.
3. Martinović D., Ćemalović M., Karišik J., Challenges of Renewable Energy Sources
4. Nacionalni akcijski plan za obnovljive izvore energije do 2020. godine, Ministarstvo gospodarstva, listopad 2013.
5. Nacionalni akcijski plan za obnovljive izvore energije do 2020. godine, Ministarstvo gospodarstva, listopad 2013.
6. Nacrt prijedloga zakona o izmjeni i dopunama Zakona o energiji, s konačnim prijedlogom zakona, Ministarstvo gospodarstva, rada i poduzetništva, Zagreb, kolovoz 2010.
7. Pravilnik o povjerenstvu za stratešku procjenu, NN 70/08.
8. Plan upravljanja okolišem projekt smanjenja rizika i prilagodba rizicima od katastrofa, 1. ožujka 2008

9. Procjena utjecaja na okoliš i strateška procjena utjecaja na okoliš. www.mzoip.hr/hr/okolis/procjene-utjecaja-na-okolis.html (20.10.2016.)
10. Rimac M., Financiranje projekata obnovljivih izvora energije, Koprivnica, studeni 2014.
11. Strategija energetskog razvoja Republike Hrvatske, NN 130/2009
12. Strateški plan Ministarstva zaštite okoliša i prirode 2015. – 2017., Zagreb, svibanj 2014.
13. Stupin, K., Stanje i perspektive energetskog zakonodavstva Republike Hrvatske, Energetski institut Hrvoje Požar, Zbornik radova pravnog fakulteta u Splitu, god. 52, 3/2015, str.623-639.
14. Uredba o strateškoj procjeni plana i programa na okoliš, NN 64/08
15. Zakon o zaštiti okoliša. NN 80/13, 153/13, 78/15
16. Wind in power, 2015 European statistics, February 2016.

LEGAL REGULATION OF USE OF THE RENEWABLE ENERGY SOURCES IN THE REPUBLIC OF CROATIA

Suzana Bardic Derencinovic
Zagreb Faculty of Law (Ph.D. student), Croatia
cyber1971@yahoo.com

ABSTRACT

In this paper the author analysis legal framework of the use of renewable sources of energy in the Republic of Croatia. Renewable sources of energy have been identified as a viable alternative to traditional sources. This goes to energy supply in general as well as in the domestic and regional context. The author emphasizes numerous advantages of using renewable energy sources – from economic to environmental. In order to support this hypothesis, the author quotes various relevant binding legal instruments that regulate use of the renewable energy sources including Directive 2009/28/EC of the European Parliament. Underlining the potential that Republic of Croatia has with regard to the extended use of renewable energy sources (the power of wind, sun, water etc.), the author points at some lacunae that have been identified within the domestic strategic framework and its implementation. This particularly goes for strengthening administrative capacities in order to increase funding of relevant projects through EU structural funds. Further improvement of these capacities should lead to the increase in the use of renewable energy sources in the Republic of Croatia. This would be possible only through full harmonization of domestic legislation with EU legal framework, reducing the bureaucracy, facilitating procedures of issuing relevant certificates etc. As an example of countries that aligned their legal framework to the European standards and significantly improved their practices, the author refers to some EU countries with well developed systems of use of the renewable energy sources. In concluding remarks, the author points out potential advantages of use of the land that has not been cultivated for planting some agricultural products that can be used as a biofuel.

Keywords: *biofuel, Directive 2009/28/EC, environmental protection, legal framework, renewable energy sources*

1. INTRODUCTION

There are multiple advantages of using renewable energy sources in comparison with traditional sources of energy. Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources underlines the need to reduce greenhouse gas emissions and the dependence on the use of other types of energy, in particular, petroleum. Over the last few years the advantage is increasingly being given to biofuels. The Preamble to the Directive emphasizes that it would be advisable for both, the European Commission and EU Member States (hereinafter referred to as the EU), to support various measures in this area both at national and regional level and to encourage the financing of these measures and programs from the structural funds that exist for this purpose. (http://eurlex.europa.eu/legalcontent/HR/TXT/?uri=CELEX%3A32009L0028, 14.04.2017.)

In this paper, we will try to explain what are Croatian potentials in using renewable energy sources and how to achieve them.

For the Republic of Croatia, this issue is relevant in view of the numerous possibilities of exploiting renewable energy sources - sea, wind and sun. But nonetheless, other EU Member States have much more developed solar energy utilization systems, with significant funding

being allocated annually, through various subsidies, etc. Solar energy is collected through solar collectors, photovoltaic systems and solar energy focus.
For example, in the Republic of Croatia, solar panels are considered as privileged sources of electricity. Regarding wind energy, the Republic of Croatia also has a lot of potential that, unfortunately, remains insufficiently used.
Croatia is not only rich in solar energy and wind power, but also in the force of the sea waves, where there is also a huge potential that should be used. However, there is also a need for substantial initial investment, which is primarily related to gathering the necessary information, project design and, ultimately, what is not an eligible cost, and that is the high cost of the necessary devices. The idea of using water force and the force of the sea waves is not new. Since the Middle Ages, there have been successful projects in this respect. China, for instance, as one of the most developed civilizations in the world, had mills on the water, and Europe has not lagged behind in that sense. (Perčić, 2016, pp. 213-214)
Strategic guidelines on the exploitation of renewable energy sources in Croatia are foreseen by the Energy Development Strategy adopted by the Croatian Parliament. According to the Strategy, about 1200 MW of wind power is anticipated by 2020. Unfortunately, like most of the issues in the Republic of Croatia that require a modern way of thinking as well as larger financial incentives like this case, we lag behind other EU countries. (https://ekoloskaekonomija.wordpress.com/2016/01/06/obnovljivi-izvori-u-hrvatskoj-stanje-31-prosinca-2015-i-perspektiva-za-2018/#fn5, 14.04. 2017.)
One of the main reasons for the insufficient use of renewable energy sources in Croatia is also the lack of adequate legal regulation. In other words, the use of renewable energy sources and their environmental acceptability are not adequately regulated and the internal mismatch of regulations at the national level, as well as some deviations from European regulations generate bureaucratic problems in obtaining certificates, difficulties in exercising the right to incentives, etc. Shortcomings in legal regulation also imply the question of the extent to which the legislative framework for the use of renewable energy sources in the function of protecting the right to a healthy environment goes, as one of the fundamental constitutional values of the Constitution of the Republic of Croatia.

2. LEGAL AND INSTITUTIONAL FRAMEWORK FOR THE USE OF RENEWABLE ENERGY SOURCES IN THE EUROPEAN UNION AND THE REPUBLIC OF CROATIA

As far as the instruments of the European Union are concerned, the EMAS (Eco Management and Audit Scheme), i.e. the Environmental management system, should be mentioned. It is an initiative of the European Union aimed at protecting the environment in public and private organizations. The intention is to minimize any possibility of creating situations that have a negative impact on the environment. Thanks to such instruments, investors, insurance companies and banks are more willing to cooperate with organizations and companies that have access to business and have environmental protection in mind (Matuszak-Flejszman, 2009, pp. 412-418).
Similarly, one of the EU instruments that assisted the countries that joined the European Union after 2004 was the Joint Assistance to Support Projects in European Regions (JASPERS). This program offers technical assistance to EU Member States and countries interested in specific projects and those Member States who want to get the financing from EU funds through their national executive agencies. These countries work with JASPERS based on an annual action plan. Among other things, JASPERS offers assistance in environmental protection projects, use of renewable energy and energy efficiency. (http://www.enu.fzoeu.hr/financiranje-ee-projekata/programi-eu/strukturni-instrumenti-eu, 14.04.2017.)

Unfortunately, comparison of the Republic of Croatia with other EU Member States, shows that we are at the very bottom on the list when it comes to the use of renewable sources of energy.
For example, on July 2016 the Eurostat emphasized that: "... In 2014. almost one quarter (25.5%) of the total EU-28 primary energy production were renewable energy sources, while the share of solid fuels 19.4%, mostly coal) was slightly lower than one fifth, while the share of natural gas was slightly lower (15.2%). Crude oil (9.1%) was the only other major source of primary energy production. The growth of primary production from renewable energy sources exceeded production growth from all other types of energy sources. It was relatively stable for most of the years between 2004 and 2014, with a slight drop in production in 2011. During that ten-year period, renewable energy production grew by 73.1%. On the other hand, the level of production from other primary energy sources in principle decreased in that period, with the largest decreases recorded for crude oil (-52.0%), natural gas (-42.9%) and solid fuels (-25, 5%), with a modest decline of 13.1% for nuclear energy."
(http://ec.europa.eu/eurostat/statisticsexplained/index.php/Energy_production_and_imports/hr, 17.4.2017.)
Also, we can see on the pages of the European Parliament what the EU considers as renewable sources of energy and which is the European Union's position about renewable energy technology. It reads as follows: "... renewable energy sources (wind energy, solar energy, hydropower, ocean energy, geothermal energy, biomass and biofuels) replace fossil fuels and contribute to the reduction of greenhouse gas emissions, diversification of energy supply and reduction of dependence on unreliable and unstable fossil fuels, especially oil and gas markets. The EU has a leading position in the world when it comes to renewable energy technologies. It holds 40% of renewable energy patents worldwide, and in 2012 almost half (44%) of the world's renewable electricity capacity (excluding hydro power) was taking place in the EU. About 1.2 million people are currently employed in the renewable energy industry in the EU. EU legislation for the promotion of renewable energy sources has developed considerably in recent years. There is currently a discussion on the future policy framework for the post-2020 period."
(http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_5.7.4.html, 14.04. 2017.)

The European Commission in its Second Energy Status Report of 1.2.2017. emphasizes that climate and energy diplomacy needs to be strengthened, ensuring compliance with the rules that have already been adopted on this issue and, before the end of 2017, to launch investment platforms, inter alia, for projects related to renewable energy sources. (http://ec.europa.eu/transparency/regdoc/rep/1/2017/HR/COM-2017-53-F1-HR-MAIN-PART-1.PDF, Brussels, 1.2.2017 COM (2017) 53 final, 15.04.2017.)
Human environment is a value protected by the Constitution. The Constitution of the Republic of Croatia, *inter alia*, states the preservation of nature and the human environment as the highest value of the constitutional order. Thus, the Art. 52 of the Constitution states that "... the sea, seaside and islands, water, air space, mineral treasures and other natural resources, as well as land, forests, wildlife and other parts of nature, property and objects of particular cultural, historical, economic and ecological significance, are legally determined to be of special interest to the Republic of Croatia. "(Constitution of the Republic of Croatia, Article 52, consolidated text, Official Gazette 85/10)
Since January 1st 2016, the Law on Renewable Energy Sources and Highly Effective Cogeneration has been in force in the Republic of Croatia (Official Gazette 100/15). Then, the Environmental Protection and Energy Efficiency Fund (FZOEU) was established on the

basis of the Environmental Protection and Energy Efficiency Fund Act establishing the framework for the implementation of Directive 2009/29 / EC of the European Parliament and of the European Council of April 23rd 2009 amending and supplementing Directive 2003/87 / EC with a view to improving and extending the Community system for the trading of greenhouse gas emission allowances (OJ L 140, 5 June 2009).
The Environmental Protection and Energy Efficiency Fund has following tasks: "Financing the preparation, implementation and development of programs, projects and similar activities in the field of:
- conservation, sustainable use, protection and improvement of the environment
- energy efficiency and use of renewable energy sources." (Law on Environmental Protection and Energy Efficiency Fund, Art. 2 st.1, Ref., NN 107/ 03, 144/12)

The Environmental Protection and Energy Efficiency Fund (FZOEU) is in fact a mediating body and as such it is a place for collecting funds that do not come from the budget funds of the Republic of Croatia. The Fund has been investing into various projects that, *inter alia*, relate to environmental protection as well as renewable energy sources. Also, the Fund cooperates with other international and domestic institutions and programs, including cooperation with the Energy Development Strategy, the National Environmental Strategy and various other programs and projects from the mentioned area.
Furthermore, the Croatian Energy Regulatory Agency (HERA) was established in the Republic of Croatia by the Law on Regulation of Energy Activities (Official Gazette 177/04 and 76/07) and continued to operate in accordance with the provisions of the Law on Regulation of Energy Activities (Official Gazette, no. 120/12). The Law on Regulation of Energy Activities prescribes that HERA is an independent and non-profit legal entity with public powers to regulate energy activities.
"The founder of HERA is the Republic of Croatia, and the founder's rights are realized by the Government of the Republic of Croatia. HERA is responsible for its work to the Croatian Parliament.
The regulation of energy activities promotes:
- efficient and rational use of energy
- entrepreneurship in the field of energy
- investing in the energy sector
- environmental protection."
(https://www.hera.hr/en/html/agencija.html, 15.04.2017.)

In 2013, the Government of the Republic of Croatia adopted the National Action Plan (NAP) for Renewable Energy Sources by 2020, thus implementing national legislation in Directive 2009/28 / EC to encourage the use of energy from renewable sources. By entering the EU, the Republic of Croatia has also decided to increase the use of renewable energy sources by up to 20% by 2020. Of course, this theory seems to be ideal but, unfortunately, the real situation shows us the lack of political will and the lack of communication between the executive authorities and their own bodies. Thus, for example, the modification of the tariff system to produce electricity from renewable energy sources has negative effect on the increase of the selling price of electricity to final consumers by increasing incentive fees. (https://www.hera.hr/hr/docs/2016/sustav_poticanja_proizvodnje_eeoi.pdf, 15.04. 2017.)

The problem is also in the definition of renewable energy sources. According to the Law on Energy Renewable Energy Sources those sources are considered as "... non- fossil energy sources (aerothermal, biomass energy, sea energy, wind energy, hydro power, geothermal and

hydrothermal energy, waste gas, gas from sewage treatment plants and biogas, solar energy)." (Law on Energy, Article 3, Official Gazette 120/12, 14/14, 95/115, 102/15).

The definition of renewable energy sources is somewhat more comprehensive in the Law on Renewable Energy Sources and Effective Cogeneration, and renewable energy sources are considered to be "... aerothermal, biomass energy, energy from bio liquids, sea energy, hydro power, wind energy, geothermal and hydrothermal energy, gas energy from waste landfills, gas from sewage treatment plants and biogas, solar energy and biodegradable part of certified waste for energy production in an economically feasible manner in accordance with regulations in the administrative area of environmental protection." (Law on Renewable Energy Sources and Highly Effective Cogeneration, Art. 4, Official Gazette, 100/15)

This discrepancy can be overcome by applying general legal principles such as *lex specialis* and *lex posterior*, but it is undeniable that internal legal mismatches generate the problem of application, particularly in the segment of analysis and reporting as well as facilitating incentives to use renewable energy sources.

3. CONCLUSION

Notwithstanding the efforts to integrate EU regulations into its domestic legislation, the Republic of Croatia has shown insufficient political and financial will in their *de facto* implementation in practice. This can be seen from too much bureaucracy, overlapping and mismatches of regulations and too high a yield that eventually come from the pockets of the final consumers. Also, the lack of communication between the executive authorities and subordinated authorities established to assist and regulate the mentioned issues does not, of course, facilitate that task. New ways to finance and use renewable energy sources need to be found, as they really represent the "energy future" for the Republic of Croatia.

In any case, the potential of renewable energy sources that Croatia has, should in no case be neglected. It would be advisable to look for ways in which initial capital needed for any investment in that sense can be absorbed from European funds and used in a favorable way.

For example, one of the benefits of wind power production is its relatively inexpensive. Initial capital for infrastructure and wind power plants is needed but these funds are starting to return very quickly. This is one of the most cost-effective investments that a country such as the Republic of Croatia should consider. We have a rugged coastline and a lot of islands that have many windy days a year and we are actually an ideal country for both wind power production and other ways of generating energy from renewable sources. Energy produced from the sun is also something to think about. The Republic of Croatia is located in the Mediterranean and one of the countries with an abundance of sunny days throughout the year. A good example of a potential model country can be Germany, which accounts for nearly one third of its total electricity demand from renewable energy sources and that is quite impressive. This energy is mainly produced through wind power and solar collectors. The German government plans to cover up to 35% of total renewable energy consumption by 2020. These estimates and results were presented by the Center for Exploration of Solar Energy and Hydrogen and Wurttemberg (ZSW) and the Federation of Energy and Water Management (BDEW). (http://www.energetika-net.com/vijesti/obnovljivi-izvori-energije/iz-obnovljivih-izvora-trecina-elektricne-energije-u-njemackoj-23910, 17.04.2017)

Likewise, a fusion reactor was successfully run by German experts at the Max Planck Institute at the end of the last year. The reactor creates a hot plasma, the process of fusion

takes place and energy is generated (http://glasistine.online/u-njiackoj-proradio-fuzijski-reaktor-vodi-prema-beskonacnom-i-cistom-izvoru-energije-a-radi-s-preciznoscu-bez-presedana/, 17.4.2017.). Germany is, in the field of electricity production from renewable sources, a pioneer, sort to speak, leading the rest of Europe in this regard. Every year the production of energy through fossil fuels is dropping and coal factories are slowly closing.

Let us only remember on what basis the EU as we know it today, was created. It was created for the common steel and coal market, and was dominated by Germany as the largest economic power in Europe, particularly in regarding coal. But today, this important branch of the German industry is slowly disappearing.

Coal mines are closing more and more each year. By the beginning of the 20th century, Germany had about 153 coal mines. As far as workers are concerned, they have not been dismissed but moved to new jobs or have received severance payments or pensions that will provide for them and their families.
(https://www.hrastovic-inzenjering.hr/primjena-energije/energetski-clanci/zastita-okolisa/item/795-ugljen-odlazi-u-povijest.html, 02.05.2017.)

As an exceptional example, as far as the EU countries are concerned, Denmark produced over 140% of the country's electricity supply in a single day and the surplus of energy was imported by other EU countries. It is interesting that on that day the windmills did not work with their full strength. (https://www.express.hr/znanost/danske-vjetrenjace-jedi-jednog-danu-opskrible-cijelu-drzavu-strujom-1710, 02.05.2017.)

Let's mention another bright example of neighboring countries, for example, Sweden, one of the EU Member States that has made the best progress alongside with Germany and Denmark in the field of renewable energy sources. Sweden has made so much progress in waste management that only 1% of the total waste produced is going to garbage burners. It is one of the first countries to generate energy through a garbage burners and at one point Sweden found itself in need of importing garbage from other countries to keep the garbage burner working to produce energy. Citizens of Sweden are generally known for their very thorough separation and recycling of waste and could serve us as a bright example in this respect. As far as solar power plants are concerned, is it not a worrying fact that a Sweden located in the far North has more solar panels than a single Croatia which is a country with a lot more sunny days in a year? (https://www.express.hr/ekonomix/vrhunska-reciklaza-u-drzavi-nemaju-smeca-moraju-ga-uvoziti-8392#, 05.05.2017.)

Hand in hand with renewable sources of energy, one of the most important issues in the recent human history is the issue of climate change. For years, experts have warned us of the global warming and adverse climate changes that this warming brings with it. It is enough that the average temperature rises up for only a few degrees and this can have cataclysmic consequences for the whole planet Earth. It is interesting that some of the world's largest economic powers are consistently refusing to do anything to counteract the greenhouse gases or make very little in this regard, putting a profit above all. An illustrative example of such an economic policy is the US which is turning back to the fossil fuels. Europe is concerned about suppressing the use of greenhouse gases as far as possible. It can serve as an example for the rest of the world. As the Republic of Croatia is concerned, unfortunately, our energy and economy are still maintained on heating oil, coal and other non-renewable sources of energy.

In addition, we do not invest enough resources in renewal and modernization of power plants. The resources that the Republic of Croatia invests in, go to the modernization of gas and oil plants, which means that we are still focused on non-renewable energy sources. One of our most important hydropower plant "Plomin" found itself in the center of interest a couple of years ago (2014) because of the controversial decision of our then government that with the help of Japanese investors it will produce electricity but on a coal basis.When developed countries in our neighborhood close mines and increasingly leave fossil fuels behind, we sign contracts with foreign investors on the operation of the hydro power plant on coal.

However, there is a hope because the new government keeps this project on ice as its strategy is based on the so-called “low-carbon strategy” that gradually abandons the use of fossil fuels in electricity production. This is also highlighted at the European Commission's mid-term review last year, that the coal plant project is considered to be unauthorized state aid. (https://www.tportal.hr/biznis/clanak/japanci-optimisticni-u-hep-u-sute-upitna-sudbina-plomina-c-20170203, 05.05.2017.)

Furthermore, there are many talented young people in the Republic of Croatia who regularly receive international awards and acknowledgments for their patents in this field, but it seems that the human resources of Croatia and its institutions have still not been sufficiently recognized. The situation could be solved by opening a number of targeted tenders in this regard, as well as by providing scholarships and various other incentives to talented people who are increasingly looking for their business opportunities elsewhere. Also, since part of the agricultural land in the Republic of Croatia is unused it would be good to plant some additional quantities of required seeds, corn or some other agricultural crops from which biofuel could be produced. This would lead to new jobs, potential biofuels exports to neighboring countries, etc.

The assumption for the implementation of these measures is to remove regulatory mismatch, better regulation of monitoring and periodic reporting on the implementation of the legislative and strategic framework for the use of renewable energy sources, simplification of the certification process, better use of joint projects with other countries, especially those from the EU etc.

Linking with potential foreign strategic partners is possible through the organization of scientific and professional conferences. For example, the Energy Investment Forum was held in Zagreb on February 16th 2017, fourth in row. It is a conference dedicated to the development of energy investment projects in Croatia and the region. In any case, it is positive that such conferences and forums are held and that can attract foreign investors and make it easier for Croatian government to realize and financially support projects to better protect the environment using renewable energy sources.

LITERATURE:

1. Constitution of the Republic of Croatia, Art. 52, consolidated text, Official Gazette 85/10
2. Energy Law, Art. 3, Official Gazette 120/12, 14/14, 95/115, 102/15
3. http://ec.europa.eu/eurostat/statisticsexplained/index.php/Energy_production_and_imports/hr, 17.4.2017.
4. http://ec.europa.eu/transparency/regdoc/rep/1/2017/HR/COM-2017-53-F1-HR-MAIN-PART-1.PDF, Bruxelles, 1.2.2017. COM(2017) 53 final, 15.4.2017.
5. http://eurlex.europa.eu/legalcontent/HR/TXT/?uri=CELEX%3A32009L0028, 14.4.2017.

6. http://glasistine.online/u-njemackoj-proradio-fuzijski-reaktor-vodi-prema-beskonacnom-i-cistom-izvoru-energije-a-radi-s-preciznoscu-bez-presedana/, 17.4.2017.
7. http://www.energetika-net.com/vijesti/obnovljivi-izvori-energije/iz-obnovljivih-izvora-trecina-elektricne-energije-u-njemackoj-23910, 17.4.2017.
8. http://www.enu.fzoeu.hr/financiranje-ee-projekata/programi-eu/strukturni-instrumenti-eu, 14.4.2017.
9. http://www.europarl.europa.eu/atyourservice/hr/displayFtu.html?ftuId=FTU_5.7.4.html, 14.4.2017.
10. https://ekoloskaekonomija.wordpress.com/2016/01/06/obnovljivi-izvori-u-hrvatskoj-stanje-31-prosinca-2015-i-perspektiva-za-2018/#fn5, 14.4.2017.
11. https://www.express.hr/ekonomix/vrhunska-reciklaza-u-drzavi-nemaju-smeca-moraju-ga-uvoziti-8392#, 05.05.2017
12. https://www.express.hr/znanost/danske-vjetrenjace-u-jednom-danu-opskrible-cijelu-drzavu-strujom-1710 , 02.05.2017.
13. https://www.hera.hr/hr/docs/2016/sustav_poticanja_proizvodnje_eeoi.pdf, 15.4.2017.
14. https://www.hera.hr/hr/html/agencija.html, 15.4.2017.
15. https://www.hrastovic-inzenjering.hr/primjena-energije/energetski-clanci/zastita-okolisa/item/795-ugljen-odlazi-u-povijest.html, 02.05.2017.
16. https://www.tportal.hr/biznis/clanak/japanci-optimisticni-u-hep-u-sute-upitna-sudbina-plomina-c-20170203, 05.05.2017.
17. Law on Renewable Energy Sources and High Cogeneration, Art. 4., Narodne novine, 100/15
18. Law on the Fund for Environmental Protection and Energy Efficiency, Art. 2. st.1., Official Gazette, revised text, 107/ 03, 144/12
19. Matuszak-Flejman. (2009). Benefits of Environmental Management System in Polish Companies Compliant with ISO 14001. *Polish Journal of Environmental Studies*. 2009. pp. 412-418.
20. Perčić, M. (2016). Renewable Energy Resources in the Context of Marine Technology - Present and Future Trends. *Maritime Review, Special Edition*. 2016. pp. 213-221.

BOOSTING CROSS BORDER E-COMMERCE IN THE EU CONSUMER LAW VS. LESS BURDENS FOR SMALL AND MEDIUM ENTERPRISES IN THE DIGITAL AGE

Suzana Kolesar
Croatian Chamber of Trades and Crafts
suzana.kolesar@hok.hr

ABSTRACT

This paper gives a short analysis of one of latest European Commission activities towards all Member States with the aim to fill the gap between public policy on consumer rights (with its extensive legislation) and the creation of an business friendly environment with less burdens for small and medium enterprises (one of the main EU objectives for economic growth). At this moment there are about 22 millions of enterprises operating within the EU and 99,8 % of them are SMEs. Together with 500 millions of EU consumers they are, if trading in the Digital Single Market, a very big potential for the growth of the EU economy. To use this potential in the cross border e-commerce, the consumers as well as the businesses need to have more trust to decide to buy and sell goods and services on-line. The SMEs often complain about the complexity of the EU and the respective national regulations, and how to comply with various regulatory requirements. To stimulate their better involvement in the Digital Single Market, the European Commission is funding activities to inform and educate the SMSs in all 28 Member States puts together the main stakeholders of that process. Despite similar problems for all SMEs across EU, specific challenges of such education are present because of different economic development and different business ethics together with the lack of motivation for education. The main objectives of this paper are possible solutions for the better results of this education in consumer rights in digital age for SMEs in EU.

Keywords: *consumer law, consumer rights, digital single market, e-commerce, SMEs training*

1. INTRODUCTION - HOW TO HAVE YOUR CAKE AND EAT IT TOO

The cause for writing this paper was the author's participation in one of the most recent activities at the EU level for encouraging cross-border e-commerce, which is planned as an education of SMEs on consumer rights in the digital age (Project - Training for SMEs on consumer rights in the digital age).

This type of education for SMEs, with the support of European Commission, is being carried out for the first time, and most importantly, with the participation of the most important stakeholders at the EU level, such as BEUC, UEAPME and EUROCHAMBRES.

The motive for writing this paper is to achieve as good results as possible as one of the national trainers in the aforementioned project for organizing the education of SMEs in Croatia, as well as developing new tools for carrying out this education, given that the author believes that existing tools would not yield the desired result.

With this goal in mind, a brief examination of the very rich documentation (primarily EU documentation) was carried out, which is important for the selection of the most appropriate ways of educating SMEs on the given areas and creating innovative training models that would be accepting of national specifities.

This paper will provide a brief overview of a part of EU legislation, from the core strategies and policies (such as Europe 2020, The Single Market Strategy, Digital Single Market Strategy and the European consumer agenda) to specific directives in the area of consumer protection and the reduction of business barriers for SMEs.

Such an approach seeks to highlight the extraordinary breadth of EU legislation, ranging from "good wishes" within certain EU policies to the specific regulation of a particular area, the most common goal being to secure and protect the freedoms, rights and interests of citizens (both consumers and entrepreneurs) within the EU.
We believe that the documents presented in this paper, along with clear positions (e.g. UEAPME Position Paper; 2015) of the main stakeholders on the objectives of stronger development of the Digital Single Market, undoubtedly show the challenges we are facing if we want to reach a win-win solution between the rights and obligations of consumers and the rights and obligations of SMEs as the main actors of economic recovery of the EU.
The paper will try to answer the question of how to implement selected SME education activities for their greater involvement in cross-border e-commerce, using the most up-to-date (available) IT tools on the market with 500 million potential consumers? (EC; The European Single Market)
Is choosing a singular and simultaneous (in all member states and including all relevant stakeholders) education of SMEs on selected areas of consumer rights protection a sufficient first step in reaching that goal, or do other, more appropriate measures have to be taken, so that the implementation of the decided goals wouldn't become just another, additional burden for SMEs?

2. EUROPE 2020 STRATEGY AS A TIP OF THE ICEBERG

If we imagine the entire EU legislation as an iceberg, the Europe 2020 Strategy would represent its tip. Europe 2020 puts the economic recovery and growth as its main goal, with respect to other objectives in the fields of ecology, climate change, employment.
Economic growth is planned to be achieved by establishing, developing and strenghtening the EU Single Market Strategy, as well as the Digital Single Market within it. With regards to that process, the EU sees remarkable potential in the fact that 21 million SMEs operate on its market (EC; The European Single Market).

The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. Within the SME category, a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million (EC Recommendation; 2003).

Through its policies, measures and activities, the EU is permanently advocating for a better business environment for SMEs, as outlined in The Small Business Act for Europe (2008), The Entrepreneurship 2020 Action Plan (2013) and Better Regulation Agenda (2015).

Thus, the concepts of Smart Regulation (2010) and Better regulation (2015) have been developed, as well the REFIT system (2015) which, with the application of the "think small first" principle, along with SME testing (Small Business Act; 2008), consistently and correctly applied represent powerful tools in creating a stimulating environment for existing SMEs and for the establishment of new ones.
One of the objectives of the EU economic recovery is also increasing employment by encouraging the development of entrepreneurial spirit among citizens throughout the EU, as well as encouraging self-employment.

Given that these incentives are directed towards citizens, the realization of this goal actually means an increase in the number of SMEs. It is precisely their establishment that is the first step in realizing the entrepreneurial ideas of individuals and in most cases includes self-employment, and often employment of family members. In Croatia, the most significant examples of such entrepreneurship are the establishment of trades/crafts and family farms. In accordance with the Croatian Crafts Act (2013), *craftsmanship is the sole and permanent performance of permitted economic activities by natural persons for the purpose of obtaining income or profits generated by production, traffic or provision of services on the market.*
For the purposes of this paper, the author examined two types of documents. One type represents a list of consumer protection legislation with special emphasis on the directives in five areas designated for the implementation of SME education on consumer rights in the digital age (Directive 2011/83/EU; Directive 1999/44/EC; Directive 93/13/EEC; Directive 2005/29/EC; Directive 2006/114/EC; Directive 2000/31/EC; Directive 2006/123/EC; Directive 2013/11/EU; Regulation (EU) 524/2013)

The other deals with the main characteristics of SMEs, as well as the most common obstacles/barriers they face when conducting their business, with emphasis on doing business online (or doing business by using digital tools).
With regards to the extensiveness of the legislation and many burdens that SMEs face in operating their business, the question arises of what would be the most adequate approach for training of SMEs for their greater involment in cross-border e-commerce. This training shouldn't become yet another burden for SMEs.
In addition to examining this information with the aim of concretizing the obstacles encountered by SMEs precisely in the cross-border e-commerce, insight into some researches and initiatives has been made (McKinsey Global Institute Report; WATIFY; High Level Group).
Furthermore, a research on education of SMEs was conducted by examining the statistical data of the largest Croatian SME association – the Croatian Chamber of Trades and Crafts, with the aim of identifying the existing ways of education and the possibilities of creating new modules, all the while respecting the requirements of the concrete project.
Given that most of the publicly available materials of the EU and other international associations were used, the largest source of information was the Internet, while official data of CCTC archives was used to present the types of SME education.

Europe 2020 is the framework for the conduct of all policies and activities on the national and the EU level with the goal of recovery of European economy and increase in employment within the EU. Single European market is one of the areas whose development was drafted by Europe 2020 and it represents one of the greatest achievements of the European Union.
The role of crafts and SMEs for Europe's economy and society is very significant. According to UEAPME (2014) "of the more than 20 million enterprises in the European Union today, 99.8% are SMEs. There are only 43,700 enterprises with more than 250 employees, but more than 19 million enterprises employ less than 10 people – the so-called micro-enterprises. The average European enterprise provides employment for six people, including the owner-manager, and SMEs count for 2/3 of private employment and close to 60% of the added value in Europe's economy. In the last decade, SMEs created 80% of the new jobs."
In this market, the potential of 21 million of SME's, as well as 500 million consumers connected in the framework of Single digital market through e-commerce represents one of the main drives of economic recovery of European Union.
OECD defines e-commerce as "*the sale or purchase of goods or services, conducted over computer networks by methods designed for the purpose of receiving or placing of orders.*

The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or services do not have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals, governments, and other public or private organizations. To be included are orders made over the web, extranet or electronic data interchange. The type is defined by the method of placing the order. To be excluded are orders made by telephone calls, facsimile or manually typed e-mail." (OECD; Glossary of Statistical Terms; 2013)

3. TRAINING OF SMEs IN DIGITAL SKILLS AND CONSUMER LAW

Research confirms that Europe does business below its digital potential, while developed Digital Single Market can contribute in trillions of Euros to economic growth in time shorter than one decade (McKinsey Global Institute Report; 2016). Still, within Single European Market, member states have different levels of economic development. The degree of economic development influences, through limited financial resources, availability and quality of standard educational system as well as other forms of education, and consequently, education of entrepreneurs.

Despite existing differences, all European SMEs are being burdened by almost the same obstacles, the main ones being emphasized by the president of UEAPME Ulrike Rabmer-Koller in May of 2017 (UEAPME; Press Release; 2017). The President stated that *"the fragmentation of the internal market hinders SMEs and start-ups in their growth. Other major problems are: access to finance, regulatory and bureaucratic burden, different tax systems as well as the challenges of digitalization."*

In order to remove regulatory and bureaucratic barriers, clear guidelines have been pointed out in the report by High Level Group (2014). The HLG recommends that the Commission rigorously apply the "Think Small First" principle and competitiveness test to all proposals for legislation, put specific focus on the needs of SMEs and micro-businesses, exempt SMEs and micro-businesses from EU obligations as far as this is possible and the political aim of the legislation is not jeopardized.

Considering all other obstacles, harmonization of business with legislative in areas of consumer protection is, considering its scope and often high demands for micro and small entrepreneurs, who are the majority of European SMEs, an additional barrier.

European legislative in the area of Consumer Protection is available at the EUR-Lex web pages, and its main goals are contained within European Consumer Agenda (2012).

With all of this in mind, we can identify the unused potential of three possible leverages of european economic recovery: number of SMEs, number of potential consumers, and the modern digital technology. The idea of connecting them through cross-border e-commerce is then understandable.

The biggest challenges are precisely before SMEs because of their market position that is burdened by barriers, but also because of their current modest participation in cross-border commerce as well as e-commerce. According to the EC (The European Single Market – SMEs access to markets) data, only 25% of EU-based SMEs export at all and only 7% of SMEs online sell cross-border (EC; Strategy; Digital Single Market).

For incentivizing inclusion of SMEs in cross-border e-commerce European commission has initiated WATIFY (2014), an awareness raising campaign that clearly articulates the necessity of knowledge and skills that SMEs need in order to be included in the digital market.

UEAPME emphasizes that the needs of SMEs in digitalization process need to be recognized and taken into account if SMEs are to be motivated for bigger inclusion in the EU digital market (UEAPME; 2016).

The newest European Commission document related to the Digital Single Market Strategy is the Communication from 10th of May 2017 that emphasizes the importance of knowledge and training of citizens and entrepreneurs in recognizing and using digital tools.
For most SMEs, especially micro and small entrepreneurs whose businesses suffer the most because of numerous obstacles mentioned beforehand, attending training or other kinds of education after they already finished mandatory education (if it wasn't prescribed by law as a requirement for operating their business), represents equally large burden as other obstacles. Most of SME owners are working for up to 65 hours per week (UEAPME data), and with the average number of employees at less than 10, they haven't got the capacity to send some of them to attend the training or education. Therefore, participation in education that is not a requirement for operating a business is relatively low.
With well-considered national SME education systems for better inclusion in Digital Single Market, for which the execution of the aforementioned project is a useful example, it is necessary to initiate, from the EU level, simultaneous and clear activity for reduction of barriers that are burdening SME business on national level, and especially in cross-border trading. Consistent implementation of the Small Business Act and application of existing tools such as "think small first" principle should be a goal whose execution would be monitored by the EC.

4. HOW TO KILL TWO BIRDS WITH ONE STONE

The latest European Commission activities that are being implemented through the BEUC project are, in the author's opinion, the correct approach towards achieving one of the set goals of the EU economic recovery.
The singular content of education adapted to national specificities, co-ordination of activities from the EU level based on the main stakeholder's positions (BEUC, UEAPME, Eurochambers) and representatives from national levels, make the planned SME education training on consumer rights in the digital age extremely promising, especially since it's carried out simultaneously in all member states, with the mutual co-operation of representatives of all member states and the transfer of best practices.
At the same time, enough space is provided, and the creation of innovative ways of implementing SME training, the search for new channels of communicating this education to potential users (SMEs) as well as to the general public are actually encouraged at the national level to get more support in implementation.
For successful training of SMEs on consumer rights in the chosen fields, it is necessary, beforehand or simultaneously, to carry out the education on the use of digital tools in business and e-commerce.
Given that the success of each of the two educations as a prerequisite for reaching the main goal of greater involvement of SMEs in e-commerce depends on educating as many entrepreneurs of this kind as possible, a large number of trainers is needed to cover all regions in particular member states and all of the economic sectors.
Considering that Digital Single Market objectives, alongside education of entrepreneurs on the use of digital tools, aim for citizen education as well, especially the youth within the educational system, a simple and logical solution to achieve both goals is imposed in connecting the education of youth to the education of SMEs.
Given that digital literacy of youth is an already established activity in the EU documents (Mid-term review and New Skills Agenda; 2017), whose implementation at national levels isn't disputable, a quality supplement to the curricula is expected with new programs in those member states where that hasn't been done yet. This should help students to acquire the necessary knowledge and skills to use digital tools. Establishment of synergy in learning

between students and SME's should be well prepared with mandatory inclusion of educational institutions, student associations, and associations of entrepreneurs.
As a possible model of synergic learning, mandatory internships can be used. Since students of most universities of applied sciences already have an obligation to complete internships in the duration of 2 weeks to 3 months, this time can be used for mutual learning. While students are learning entrepreneurial skills, they could be at the same time teaching digital skills to SMEs in return.
This way, the constantly emphasized need for connection of educational institutions and the economy, would come to fruition as a development of a new (perhaps permanent) educational system whose results could be simultaneously used by students and entrepreneurs.
Such education would be permanently creating the conditions for better inclusion of SMEs and students (present and future consumers) in e-commerce, mutual trust would be developing, as well as trust in the online market, and the education on consumer rights in the digital age would have a quality foundation.
In order for synergy in this mutual learning to be successful, in parallel with the creation of the system itself, as *conditio sine qua non*, SMEs have to be given relief from the biggest burdens in doing business, in order to free their capacity for new knowledge and new ways of doing business, and to motivate them to take a step towards unified EU market in the digital age.
Reduction of the most important barriers to SMEs should be carried out in accordance with a clear action program at the EU and member states levels, with the participation of European (UEAPME, Eurochambres, BusinessEurope etc.) and national SME associations.

5. CONCLUSION

EU needs to decisively and systematically enhance the application of existing tools for reduction of barriers to business for European SME's, and thereby free their capacities for accepting challenges of using modern digital technologies in business and include them in e-commerce within the Digital Single Market.
This very much needed education will then not be seen by SMEs as a new burden or obligation but as an opportunity for acquiring the necessary skills and knowledge to increase their competitive capabilities. We believe that the innovative methods of mutual learning between students and entreprenuers during internships proposed in this paper are particulary appropriate for SMEs, because they don't require leaving the workplace, and carry additional potential for mutual building of trust, as well as trust in the online trade and online market.
This kind of SME training in digital knowledge and skills, with additional education on consumer rights can be conducted as a pilot education in Croatia, with participation of graduate students of economy, law, entrepreneurship and IT, along with successful entrepreneurs that are not yet participating in e-commerce.
We believe that the support of institutions of higher education, student association, and business association would not be lacking. Aquired practical experience would be disseminated among main European stakeholders in the area of consumer protection and the representation of SMEs interests, as well in the fields of youth and entrepreneurs' education with the aim of their improvement.

LITERATURE:

1. BEUC - Bureau Européen des Unions de Consommateurs / The European Consumer Organisation, Retrieved 29.05.2017 from http://www.beuc.eu/about-beuc/who-we-are,
2. Better regulation for better results - An EU agenda (2015) Communication From The Commission To The European Parliament, The Council, The European Economic And Social Committee And Thecommittee Of The Regions Better regulation for better results

- An EU agenda. Retrieved 29.05.2017 from https://ec.europa.eu/info/law/law-making-process/better-regulation-why-and-how_en
3. Crafts Act (2013) Official Gazette No. 143/2013
4. Digital Single Market Strategy for Europe (2015), Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2015) 192 final, Retrieved 29.05.2017 from http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0192&from=EN
5. Digital Single market, European Commission Retrieved 30.05.2017 from https://ec.europa.eu/digital-single-market/en/
6. Entrepreneurship 2020 Action Plan (2013) Communication from the Commission to the European parliament, the Council, the European economic and social committee and the Committee of the regions Entrepreneurship 2020 Action plan Reigniting the entrepreneurial spirit in Europe /* COM/2012/0795 final Retrieved 29.05.2017 from https://ec.europa.eu/growth/smes/promoting-entrepreneurship/action-plan_en
7. EUROCHAMBRES Retrieved 29.05.2017 from http://www.eurochambres.eu/Content/default.asp?pagename=WhoWeAre
8. European Commission; Growth; The European Single Market (Retrieved 30.05.2017. from https://ec.europa.eu/growth/single-market_en)
9. European Consumer Agenda (2012), Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A European Consumer Agenda - Boosting confidence and growth /* COM/2012/0225 final */*, Retrieved 30.05.2017 from http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52012DC0225
10. Electronic commerce (e-commerce), OECD Glossary of Statistic Terms, retrieved 30.05.2017 from http://stats.oecd.org/glossary/detail.asp?ID=4721
11. Final Report of the High Level Group: "Cutting Red Tape in Europe – Legacy and Outlook" (2014), High Level Group on Administrative Burdens, European Commission, (Retrieved 30.05.2017 from http://ec.europa.eu/info/files/final-report-high-level-group-cutting-red-tape-europe-legacy-and-outlook_hr)
12. Mckinsey Global Institute Report; Digital Europe: Realizing the continent's potential; 2016 (Retrieved 30.05.2017. from http://www.mckinsey.com/business-functions/digital-mckinsey/our-insights/digital-europe-realizing-the-continents-potential)
13. Mid-Term Review on the implementation of the Digital Single Market Strategy (2017), Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review on the implementation of the Digital Single Market Strategy A Connected Digital Single Market for All COM(2017) 228 final
14. Retrieved 30.05.2017 http://europa.eu/rapid/press-release_IP-17-1232_en.htm
15. New Skills Agenda for Europe http://ec.europa.eu/social/main.jsp?catId=1223 Communication from the Commission to the European parliament, the Council, the European Economic and Social Committee and the Committee of the Regions a New Skills Agenda for Europe Working Together to Strengthen Human Capital, Employability and Competitiveness {SWD(2016) 195 final}
16. Pilot project — Development and organisation of training for SMEs on consumer rights in the digital age, TED – Tenders electronic daily, Retrieved 29.05.2017 from http://ted.europa.eu/udl?uri=TED:NOTICE:40979-2017:TEXT:EN:HTML
17. REFIT Platform (2015) Retrieved 29.05.2017 from https://ec.europa.eu/info/law/law-making-process/overview-law-making-process/evaluating-and-improving-existing-laws/reducing-burdens-and-simplifying-law/refit-platform_en

18. Statistics on small and medium-sized enterprises (2015). Retrieved 29.05.2017 from http://ec.europa.eu/eurostat/statistics-explained/index.php/Statistics_on_small_and_medium-sized_enterprise
19. SME' Definition, Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (Text with EEA relevance) C(2003) 1422) Retrieved 29.05.2017 from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32003H0361
20. SME Test https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/sme-test_hr
21. SME needs have to be better recognised in digitalisation process (2016), UEAPME Retrieved 30.05.2017 http://www.eubusiness.com/Members/UEAPME/digitalisation
22. Smart regulation (2010), Communication From The Commission To The European Parliament, The Council, the European Economic and Social Committee And The Committee Of The Regions Smart Regulation in the European Union. Retrieved 29.05.2017 from
23. http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52010DC0543
24. Small Business Act for Europe (2008) Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - "Think Small First" - A "Small Business Act" for Europe {SEC(2008) 2101} {SEC(2008) 2102} /* COM/2008/0394 final * Retrieved 29.05.2017 from https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act_en
25. Single Market Strategy (2015) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Upgrading the Single Market: more opportunities for people and business COM(2015) 550 final, Retrieved 30.05.2017 from https://ec.europa.eu/growth/single-market/strategy_en
26. UEAPME - Union Européenne de l'Artisanat et des Petites et Moyennes Entreprises / The European Association of Craft, Small and Medium-sized Enterprises Retrieved 29.05.2017 from http://www.ueapme.com/spip.php?rubrique1
27. UEAPME General SME policy position papers; November 2015: We need a renewed and strengthened EU policy for Crafts and SMEs (Retrieved 30.05.2017. from http://www.ueapme.com/spip.php?rubrique2)
28. Europe 2020 Strategy (2020), Communication from the Commission Europe 2020: A European Strategy for Smart, Sustainable and Inclusive Growth COM(2010) 2020 , Retrieved 29.05.2017 from http://ec.europa.eu/eu2020/pdf/COMPLET EN BARROSO 007 - Europe 2020 - EN version.pdf
29. UEAPME press release; Crafts and SMEs priorities for the next term of the European Commission and the European Parliament (Retrieved 30.05.2017. from http://www.ueapme.com/IMG/pdf/140611_UEAPME-2020_final.pdf)
30. UEAPME 2016 Ueapme news http://www.ueapme.com/spip.php?rubrique15
31. Ueapme EU policy for Craft and SMEs http://www.ueapme.com/IMG/pdf/151118_SMEpolicyreview_UEAPME-BE.pdf
32. Watify Stimulating Digital Entrepreneurship, European Commission
33. Retrieved 30.05.2017 from https://ec.europa.eu/growth/tools-databases/dem/watify

RELATIVIZATION OF ELECTORAL RIGHT EQUALITY PRINCIPLE

Mato Palic
LLD, Assist. Prof., Josip Juraj Strossmayer University of Osijek,
Law School, Osijek, Croatia
mpalic@pravos.hr

ABSTRACT

The constitutional principle of electoral right equality emanates from the general legal principle of equality as an integral element of the rule of law concept. The rule of law represents the basic and the highest constitutional principle of modern democratic states. A coherent and fair implementation of the electoral right equality principle provides for the respect of a heterogeneous electorate structure in elections and an almost equal possibility to participate in political decision-making. The aforementioned facts represent a constitutional barrier to the political parties' monopoly; nonetheless, the electoral systems' most detailed normative regulation degree proceeds at the level of legislative norming, and such a decision type necessitates a considerably lesser consensus degree and parliament legitimacy. That enables a smaller number of larger parliamentary political parties to influence election outcomes while directly but very refinedly regulating certain electoral system's elements. In a violation of electoral right equality principle, constituency size, election threshold, a vote-to-mandate calculation formula and malapportionment exert an especially important influence. The adduced elements interfere in such a way that they potentiate the votes of larger and stronger political parties. In that sense, we may say that that the Constitution is being altered materially, without modifying the formal Constitution in the process of single constitutional principle implementation. The electoral right equality de iure ceases to be so de facto. We are of an opinion that the aforementioned statements can be empirically verified on the example of the Republic of Croatia, as well as on the example of a series of other countries. A comparative research of the adduced problematic might verify the explicated theses. A possible solution to the adduced problems lies in the constitutionalization of certain type of electoral system and its constituent elements. This prevents a facilitated alteration and stabilizes both the electoral and the constitutional system as a whole. Additionally, a very significant role herein is played by constitutional courts as the guardians of Constitution and the guarantors of protection of basic political rights. A comparative survey of these courts' practice, as well as that of the supranational European ones, may provide for a more complex insight into the realization of basic constitutional principles with regard to transparency and electoral system's equity.

Keywords*: constitutional court, electoral right equality, electoral system, rule of law*

1. INTRODUCTION

The principle of representative democracy in elections is founded on three essential principles. The first principle is the inclusion manifested in general suffrage, the second is manifested in equality implying equal suffrage and the third is a form of majority decision-making. Each of these three principles operates divergently according to the content and the country of application depending on its political, cultural, sociological and historical features. Different restrictions of suffrage have been gradually reduced at different speed depending on the country. Nevertheless, there is a trend of expansion of suffrage to the growing population. In addition, there is a similar trend when it comes to shift from unequal to equal suffrage, which will be discussed further in the paper. Finally, the majority principle is inherent to every modern democratic state. The majority decision-making spreads capillary in all

representative and executive bodies regardless of the level of authority in a particular state. This principle exceeds to supranational level of decision-making specific for the European Union. The paper pays special attention to real and not only to formal equal suffrage that is frequently expressed in a formula – *one voter one vote*. The equal suffrage is implied and normatively stipulated in constitutions of many democratic states. However, there is a significant difference between formal and factual equality, i.e. in certain cases the existence of real and true connection between both aforementioned terms can be put in question. The existence of deviation in the number of voters of different constituencies is one but not the only way of relativizing the formal equal suffrage.

2. CONSTITUTIONAL FRAMEWORK AND BASIC ELEMENTS OF THE ELECTORAL SYSTEM IN THE REPUBLIC OF CROATIA

The Constitution of the Republic of Croatia defines the basic principles of electoral system. They are elaborated by legal norms. Universality of suffrage has been restricted to the age census of 18 years regardless of the type of election, of either passive or active suffrage. Equal suffrage has not been relativized by explicit constitutional or legal norms. However, the election outcome for the period from 2000 to 2016 shows that the Croatian electoral system is proportional only by its name and not by its real effects. Significance of electoral regulation derives from the fact that electoral laws are by the letter of the Constitution organic, and require qualified majority for their passing in the parliament. Besides national law, the European Convention on Protection of Human Rights and Fundamental Freedoms is in force in the Republic of Croatia and it comprises a very short legal formulation applicable to elections. It should be noted that the European Court of Human Rights in reference to the issues related to the electoral system, respects the doctrine of the margin of appreciation for every single member state of the Council of Europe (Yumak and Sadak vs. Turkey, ECHR, 2008.). Since 2000 in the Republic of Croatia, D'Hondt system of proportional representation in ten constituencies has been applied. District magnitude amounts to fourteen representatives. Apart from the mentioned constituencies, there are two additional constituencies in which eight representatives of national minorities are elected by the majority system and three representatives of Croatian citizens resident outside the Republic of Croatia are elected by proportional electoral system and by application of D'Hondt method of calculating the votes. In ten general constituencies, a unique electoral threshold of five percent of valid votes has been set. The areas of ten general constituencies were determined in line with the law passed in 1999 according to which six elections of the representatives for the Croatian Parliament were held. The number of voters between constituencies may deviate at +/- 5%. The Report of the Constitutional Court of the Republic of Croatia of 8 December 2010 is, from the constitutional point of view, of great importance. The Report notifies the Croatian Parliament (Sabor) of considerable deviations in the number of voters in certain constituencies at elections held in 2007, which in case of failure to harmonize with the state of affairs "could become unacceptable from the constitutional perspective"(Report of Croatian Parliament, 2010). In spite of this formulation, the Croatian Parliament (Sabor) did not intervene in normative legal sense. Upon the Report, three parliamentary election cycles were held in the Republic of Croatia.

3. EQUAL SUFFRAGE RELATIVISATION PATTERNS IN THE CROATIAN ELECTORAL SYSTEM

In optimal circumstances, the electoral systems should operate as machines with two basic functions. The first function is to record valid votes of the voters and the second is to project the recording to the representative body. Mathematical restrictions disable full proportionality between the number of votes and allocation of seats. Nevertheless, the Croatian electoral

system, although formally proportional, has some features that are more characteristic of a majority system regardless of the variant in which the majority system is implemented. The key elements with direct impact on equality of electoral system and consequently to the proportionality of electoral system as a whole are the size of the constituency, formula for allocation of seats and the electoral threshold. If we adopt the standpoint that there is a single electoral system in the Republic of Croatia, the question arises, whether this is in accordance with the basic constitutional principles, in particular the ones referring to equal suffrage. This principle cannot be reduced to the maxim *one man – one vote*, since it implies real equality in cases when every vote equally influences the electoral result expressed in the way of allocation of seats in the representative authority, i.e. the Croatian Parliament (Sabor). In this context, we speak of substantial equal suffrage (Code of good practise in electoral matters, 2002). The size of the constituency comprising fourteen elected representatives is quite well set from the proportionality aspect as regards the effects that the electoral system could have. However, imbalance in the number of voters of different constituencies, the vote calculation method and in lesser extent the electoral threshold have negative effects. The manifestation of the aforementioned is a serious violation of equal suffrage that borders on discrimination in view of political orientation at national level. We consider it necessary to pay particular attention to imbalance of the number of voters between different constituencies in which equal number of representatives is elected. In the course of six electoral cycles, aberrations in the number of voters in each electoral cycle were observed. The following table shows the differences in the number of voters at elections held in 2000.

Table 1. – Voters in 2000 elections

363434	385179	365094	333735	381150	345904	372446	375114	372363	391959	
I	II	III	IV	V	VI	VII	VIII	IX	X	
363434	385179	365094	333735	381150	345904	372446	375114	372363	391959	
	5.98	0.46	8.9	4.87	5.07	2.48	3.21	2.46	7.85	I
		5.5	**15.41**	1.06	**11.35**	3.42	2.68	3.44	1.76	II
			9.4	4.4	5.55	2.01	2.74	1.99	7.36	III
				14.21	3.65	**11.6**	**12.4**	**11.57**	**17.45**	IV
					10.19	2.34	1.61	2.36	2.84	V
						7.67	8.44	7.65	**13.31**	VI
							0.72	0.02	5.24	VII
								0.74	4.49	VIII
									5.26	IX
										X

(Source: The State Electoral Commission data on the number of voters accessible at: http://www.izbori.hr/2000Sabor/index.htm)

The data show that 10 % of all proportions of the number of voters deviate from the legal threshold of 10 %.

The following table clearly shows the differences in the number of voters at elections held in 2003.

Table following on the next page

Table 2. – Voters in 2003 elections

358461	388713	365042	328076	360242	343857	382084	374678	388450	401333	
I	II	III	IV	V	VI	VII	VIII	IX	X	
358461	388713	365042	328076	360242	343857	382084	374678	388450	401333	
	8.44	1.84	9.26	0.5	4.25	6.59	4.52	8.37	**11.96**	I
		6.48	**18.48**	7.9	**13.04**	1.73	3.75	0.07	3.25	II
			11.27	1.33	6.16	4.67	2.64	6.41	9.94	III
				9.8	4.81	**16.46**	**14.2**	**18.4**	**22.33**	IV
					4.77	6.06	4.01	7.83	**11.41**	V
						11.12	8.96	**12.97**	**16.72**	VI
							1.98	1.67	5.04	VII
								3.68	7.11	VIII
									3.32	IX
										X

(Source: The State Electoral Commission data on the number of voters accessible at: http://www.izbori.hr/2000Sabor/index.htm)

The data show that 13.3 % of all proportions of the number of voters deviate from the legal threshold of 10 %.

The following table clearly shows the differences in the number of voters at elections held in 2007.

Table 3 – Voters in 2007 elections

361236	399648	366005	335091	372163	356575	403812	385594	428590	416017	
I	II	III	IV	V	VI	VII	VIII	IX	X	
361236	399648	366005	335091	372163	356575	403812	385594	428590	416017	
	10.63	1.32	7.8	3.02	1.31	**11.79**	6.74	**18.65**	**15.16**	I
		9.19	**19.27**	7.39	**12.08**	1.04	3.64	7.24	4.1	II
			9.23	1.68	2.64	**10.33**	5.35	17.1	**13.66**	III
				11.06	6.41	**20.51**	**15.07**	**27.9**	**24.15**	IV
					4.37	8.5	3.61	**15.16**	**11.78**	V
						13.25	8.14	**20.2**	**16.67**	VI
							4.72	6.14	3.02	VII
								11.15	7.89	VIII
									3.02	IX
										X

(Source: The State Electoral Commission data on the number of voters accessible at: http://www.izbori.hr/izbori/izbori07.nsf/fi?openform)

The data show that 21.11 % of all proportions of the number of voters deviate from the legal threshold of 10 %. Four figures out of this number exceed the disparity tolerated by law.

The following table clearly shows the differences in the number of voters at elections held in 2011.

Table 4. – Voters in 2011 elections

358750	403716	364332	333927	367654	352471	413148	385376	440597	422392	
I	II	III	IV	V	VI	VII	VIII	IX	X	
358750	403716	364332	333927	367654	352471	413148	385376	440597	422392	
	12.53	1.56	7.43	2.48	1.78	15.16	7.42	**22.81**	**17.74**	I
		10.81	**20.9**	9.81	**14.54**	2.34	4.76	9.14	4.63	II
			9.11	0.91	3.37	13.4	5.78	**20.93**	**15.94**	III
				10.1	5.55	**23.72**	**15.41**	**31.94**	**26.49**	IV
					4.31	**12.37**	4.82	**19.84**	**14.89**	V
						17.21	9.34	25	**19.84**	VI
							7.21	6.64	2.24	VII
								14.33	9.61	VIII
									4.31	IX
										X

(Source: The State Electoral Commission data on the number of voters accessible at: http://www.izbori.hr//2011Sabor/rezultati/rezultati.html)

The data show that 20 % of all proportions of the number of voters deviate from the legal threshold of 10 %. Particularly indicative data for this election show that the proportion of the number of votes between the fourth and the ninth constituency is 31.94 % i.e. three times higher than the disparity tolerated by law. This means that the votes of the voters of the fourth constituency are 31.94 % stronger than the votes of the voters of the ninth constituency due to the fact that the same number of representatives was elected in both constituencies.

The following table clearly shows the differences in the number of voters at elections held in 2015.

Table 5. – Voters in 2015 elections

346225	394475	352368	332101	363569	343729	410988	384987	425047	401576	
I	II	III	IV	V	VI	VII	VIII	IX	X	
346225	394475	352368	332101	363569	343729	410988	384987	425047	401576	
	13.94	1.77	4.25	5.01	0.73	18.71	11.2	**22.77**	**15.99**	I
		11.95	**18.78**	8.5	**14.76**	4.19	2.46	7.75	1.8	II
			6.1	3.18	2.51	**16.64**	9.26	**20.63**	**13.96**	III
				9.48	3.5	**23.75**	**15.92**	**27.99**	**20.92**	IV
					5.77	**13.04**	5.89	**16.91**	**10.45**	V
						19.57	12	**23.66**	**16.83**	VI
							6.75	3.42	2.34	VII
								10.41	4.31	VIII
									5.84	IX
										X

(Source: The State Electoral Commission data on the number of voters accessible at: http://www.izbori.hr/140zas/rezult/1/nrezultati.html)

The data show that 22.2 % of all proportions of the number of voters deviate from the legal threshold of 10 %.

The following table clearly shows the differences in the number of voters at elections held in 2016.

Table 6. – Voters in 2016 elections

344639	393818	353569	329852	359120	341380	410663	383947	422985	400227	
I	II	III	IV	V	VI	VII	VIII	IX	X	
344639	393818	353569	329852	359120	341380	410663	383947	422985	400227	
	14.27	2.59	4.48	4.2	0.95	**19.16**	**11.41**	**22.73**	**16.13**	I
		11.38	**19.39**	9.66	**15.36**	4.28	2.57	7.41	1.63	II
			7.19	1.57	3.57	**16.15**	8.59	**19.63**	**13.2**	III
				8.87	3.49	**24.5**	**16.4**	**28.23**	**21.34**	IV
					5.2	**14.35**	6.91	**17.78**	**11.45**	V
						20.29	**12.47**	**23.9**	**17.24**	VI
							6.96	3	2.61	VII
								10.17	4.24	VIII
									5.69	IX
										X

(Source: The State Electoral Commission data on the number of voters accessible at: http://www.izbori.hr/izbori/ws.nsf/961C6C811DCA99A4C125803A002E06D7/$FILE/Sluzbeni_rezultati_Sabor_2016.pdf)

The data show that 25.6 % of all proportions of the number of voters deviate from the legal threshold of 10 %. This exceeds the total number by one fourth, which indicates the high level of unequal suffrage.

The data clearly suggest that in some combinations of the proportions the difference between the number of the voters more or less deviates from legally stipulated +/- 5 %. This poses a question of legality of the election held. Additionally, the question arises if the equal suffrage is impaired to the extent that it would allow declaring the elections unconstitutional in whole. The answer to this question depends on a number of various elements. Firstly, violation of equal suffrage is not the only and exclusive outcome of malapportionment but it is the result of interaction of all elements within an electoral system. The effect of malapportionment on election results as a whole depends on whether the outcome of the election would have been the same if there had not been such significant deviations in the number of voters, provided that all other elements of the electoral system remained unchanged. This depends on how different areas of the constituencies would affect the allocation of seats both individually i.e. at the level of one constituency and collectively i.e. at the level of all ten constituencies. The answer to this question could be affirmative if we consider the fact that there are slight differences in the number of votes between different seats allocations due to the application of D'Hondt method of calculation of votes and with the size of the constituency set to 14 elected representatives. This means that delimitation of areas of constituencies would result in the difference in at least one and quite probably in more seats at the level of the state as a whole. Therefore, it is necessary to initiate the changes of the areas of constituencies.

There are three possibilities in this context. The first and the simplest is that all ten constituencies are abolished and one is introduced representing the area in whole. The second possibility is to change the borders of the constituency areas thus setting the balance between diverse numbers of voters. Finally, the third possibility is to keep the existing borders or to introduce a change in a way that in different constituencies a different number of

representatives is elected. In any case, constitutional duty of the legislative body is to react by setting the norms necessary for the protection of fundamental rights. Imbalances in the number of voters in the Republic of Croatia are partially caused by disorder in voter registers. In spite of the fact that the registers had been revised, the imbalance remained. Regardless of the opinion given by the Constitutional Court of the Republic of Croatia, which indicated that there were significant deviations, the Croatian Parliament never reviewed legal provisions defining the constituency areas with an aim of bringing obvious illegal deviations into balance. There are certain formulas by which malapportionment can be measured. One of the more precise measures showing the level of deviation, with few transformations, is based on Loosemore-Handby disproportionality index expressed in the formula MAL==(1/2)$\sum$ | s1-v1 | (Samuels, D., Snyder, R, 2001).

This formula shows the total number of seats that are subject to rearrangement due to malapportionment. The following table shows the percentage of seats rearranged for all elections held in the observation period.

Table 7. -Percentages (elections in the observed period)

Election year	Percentage of rearranged seats
2000	17.3
2003	22.5
2007	22.9
2011	21.3
2015	24
2016	27

Another approach to malapportionment is used by Koppel Moshe and Diskin Abraham who suggest the application of cosine measure stating that their idea cosine function is entirely in accordance with standard trigonometry cosine function (Koppel, M., Diskin, A, 2009).

In conclusion, the aforementioned data show a certain correlation between the percentage of the number of constituencies in which the number of voters significantly differs and the percentage of the seats that would be otherwise arranged if there was no malapportionment. This result confirms a need for further research into electoral systems aiming at more precise establishing and marking off the extent of malapportionment influence on the election results proportionality. Namely, other elements of electoral system influence the proportionality index. In order to assess malapportionment correctly, a comparative analysis of the changes taking place in other elements of electoral system is required both individually and combined. Such approach facilitates precise detecting of to what extent the differences in the number of voters of different constituencies influence the election results proportionality, i.e. the equality of suffrage as a universal and constitutionalized principle. Bhavnani emphasizes double under-representation as a very interesting approach to the problem of malapportionment generally involving underrepresentation of a certain part of population from more numerous constituencies in executive and not only in representative bodies. The author concludes that underrepresentation in executive bodies deriving from malapportionment is even more significant when it comes to the executive body i.e. government because ministers are more powerful than the representatives in the parliamentary system (Bhavnani, Rikhil R.,2015).

4. A CASE-LAW COMPARATIVE STUDY REGARDING MALAPPORTIONMENT

In the jurisprudence of the highest courts, there is not a unique opinion on essential elements regarding malapportionment. In one of the recent decisions, the Supreme Court of the US holds that deviations in the number of voters from different constituencies are not constitutionally relevant but the deviations in the population number (Judgement of Supreme Court of the United States Evenwel et. al. v. Abbott, 2016). In our opinion, this attitude is wrong. In spite of the fact that the elected representative represents the whole nation according to the concept of free representative seat, the fact must not be neglected that only a part of population takes part in elections – as political nation, i.e. voters. This part of population gives electoral, input legitimacy to elected representatives (Scharpf, Fritz W..1998). Thus, Scharpf Fritz W. explains that input dimension of legitimacy means that collectively binding decisions have their source in authentically expressed preferences of the core electorate of the constituency. In addition, the author explains that input legitimacy is one, if not the only form of legitimacy defining the output dimension in a way that collectively binding decisions should serve the interests of the constituency. This is a key argument for which the number of voters could be the only referential value for comparing the number of voters between different constituencies. In the former decision of the Supreme Court of the US, the deviation of the number of voters of some constituencies amounted to almost 40 % and on the other hand, the difference in the number of population was 8.04 % i.e. within the legal threshold of 10 %. In the European states the prevailing standpoint is that, related to the calculation of the values of malapportionment, the referential value should be the number of voters. Thus, the German Constitutional Court in the decision BvrfGE 130 16 of 1963 clearly established that " ...the principle of equal suffrage means that everyone should be able to exercise his or her right to vote in a formally and equal way as possible....In a pure majority voting system constituting of electoral district equal size the weight of each individual vote is equal when all ballots have the same value; electoral equality in a system of proportional representation requires a similar weight of votes...". The Japanese Supreme Court took an interesting stand on the mentioned issues. In the period from 1976 to 1995 in six different decisions, it concluded that every proportion will be considered unconstitutional as soon as it exceeds 1:2.92 quotient (number of voters/number of representatives per one constituency) elected.

5. CONCLUSION

In the summary of the analysis of disparity in the number of voters of different constituencies during six parliamentary elections held in the Republic of Croatia it should be emphasized that malapportionment is a very subtle and fine way of influencing the election results. Unlike gerrymandering that is quite easy to detect for its unusual form of constituencies, malapportionment can also be found in electoral systems with very compact form of constituency areas. There is sometimes a thin line between these two ways of violation of suffrage because setting the borders of constituencies in both cases can be motivated by achieving very specific political aims and one form of relativizing the equality of suffrage can turn into another. Two main disadvantages to the existing normative framework governing the Croatian electoral procedure are absence of legal obligation to review the number of voters on constituencies in regular periods related to elections and considerably inaccurate voter registers. The combination of these two deficiencies has proven to be very disadvantageous in exercising the constitutionally guaranteed principle of equal suffrage. The Constitutional Court of the Republic of Croatia has an important role when it comes to

protection of constitutional principles and exercise of fundamental rights and freedoms. It was only on one occasion that the Court warned the legislator that keeping the existing borders of constituencies could have constitutionally unacceptable outcomes. However, this warning in spite of the gravity of the content was not correctly comprehended and it remains to be seen whether the Constitutional Court, in exercising its constitutionality and legality revision powers related to elections, will make a step further and declare some of the future elections unconstitutional and illegal due to the legislator's disregarding attitude. The paper aimed at analysing the value of malapportionment interrelating with differences in percentage of the number of votes of different constituencies. It proved that between the higher frequency of significant deviations in the number of voters and slightly higher malapportionment values there is an interrelation in view of positive correlation. Besides, malapportionment can be considered differently. It is possible to analyse the differences in the number of voters primarily by determining the arithmetical mean of the total number of voters and then calculate dispersion. In our opinion, this approach is not be justified because the sense of malapportionment can be seen in a whole only by continuous pairing and comparison of one single constituency, respectively, with all other constituencies. It is the only way to comprehend to what extent the number of voters in one constituency differs from the other.

LITERATURE:

1. Case of Yumak and Sadak v. Turkey (Application no. 10226/03, Judgement from 08. July 2008)
2. Report on the unequal weight of votes in certain constituencies Articles 2 to 11 of the constituencies for the election of representatives in the House of Representatives of the Croatian Parliament of 08.12.2010, Official Gazette No. 142/10.
3. Code of good practise in electoral matters, CDL-AD (2002), Venecijanska komisija Vijeća Europe, accessible at: http://www.venice.coe.int/webforms/documents/default.aspx?pdffile=CDL-AD(2002)023rev-e)
4. Samuels, D., Snyder, R., The Value of Vote: Malapportionment in Comparative Perspective, British Journal of Political Science ,Vol. 31, 2001, p. 655.
5. Koppel, M., Diskin, A., Measuring Disproportionality, Volatility and Malapportionment: Axiomisations and Solutions, accessible at: https://pdfs.semanticscholar.org/8af1/1800064719b80c0524af3a5243455c33049b.pdf
6. Bhavnani, Rikhil R., The Effects of Malapportionment on Cabinet Inclusion: Subnational Evidence from India, accessible at: https://faculty.polisci.wisc.edu/bhavnani/wp-content/uploads/2013/09/Bhavnani-Malapportionment-web-version.pdf
7. Judgement of Supreme Court of the United States Evenwel et. al. v. Abbott, governor of Texas, et. al. No. 14/940. of 04.04.2016 accessible at: https://www.supremecourt.gov/opinions/15pdf/14-940_ed9g.pdf
8. Scharpf, Fritz W., (1998): Interdependence and democratic legitimation, MPIfG working paper, 1998, No. 98/2, p.3.

UNILATERAL EFFECTS IN THE EU MERGER CONTROL

Daria Kostecka-Jurczyk
Uniwersytet Wrocławski, Poland
daria.kostecka-jurczyk@uwr.edu.pl

ABSTRACT
Merger control constitutes one of the most important pillars in the EU competition policy. European Commission assess mergers in the light of risk of distortion of effective competition. To check such as risk is being applied the SEIC test. It allows answer the question whether the merger results of the creation or strengthening of a dominant position or cause coordinated and unilateral effects. The aim of this paper is to answer a question whether assessment unilateral effects in merger procedure is really important and what tools are used to verify them. The analysis will be held on the basis of the decisional practice of the EU Commission.
Keywords*: competition law, control of concentration, merger assessment, unilateral effects*

1. INTRODUCTION

With the last reform, carried out in 2004, the EU merger control law saw certain changes with regard to rules for assessment of transactions by the European Commission. The SIEC (significant impediment of effective competition) test was implemented and the change consisted in the fact that dominant position ceased to be the sole main criterion in the assessment of concentrations. Until 2004, the creation or strengthening of a dominant position constituted the grounds for the European Commission to issue a prohibition of concentration. A concentration was allowed, insofar as it did not create or strengthen a dominant position which would significantly impede effective competition in the common market or in its part (Art. 2 (2) of the Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, OJ 1990, L 257/13). Even though the Commission proposed to uphold the dominance test as the primary substantive criterion for assessment of concentrations that fell within the scope of its jurisdiction, the Council implemented the new SIEC test. At present, Art. 2 (2) of the Council Regulation (EC) No 139/2004 provides that:

"A concentration which would not sig0nificantly impede effective competition in the common market or in a substantial part of it, in particular because of the creation or strengthening of a dominant position, shall be declared compatible with the common market."

Council Regulation (EC) No 139/2004 takes a broader approach to the issue of assessment of concentration. It has two objectives:

1) prohibiting concentrations resulting in a creation or strengthening of a dominant position

2) preventing concentrations which lead to a non-collusive oligopoly and do not result in the creation of an individual or joint dominant position, but have effects that would significantly impede effective competition in the common market or in a substantial part of it.

For instance, in the Commission decision of 6 June 2006 in case no. COMP/M.4141 *Linde/BOC* (OJ C181/13), the test was applied to assess a reported concentration on the helium market. The Commission prohibited the merger stating that it would significantly impede the competition on the relevant market, although the merged undertaking would not become a market leader. This amendment of merger assessment criteria in the EU was meant

to fill certain gaps in the existing legislation (N. Tyson.(2007). *Joint Venture Regulation under European Competition Law: An Update*, European Law Journal, Vol. 13 (3), pp. 408-418.)

The problem was, that the previously applicable dominance test could not have been extended to certain concentrations that had anti-competitive effects, but did not result in the creation or strengthening of a dominant position. In the *Airtours* judgment the CFI held that the essence of collective dominance is a silent collusion between the suppliers, indicating that neither the notion of dominance of a single undertaking nor the notion of collective dominance covers situations where the merged undertaking, being a member of an oligopoly, is able to benefit from unilateral effects of eliminating a competitor after a concentration, but not necessarily from coordinated effects of tacit collusion with other members of the oligopoly (CFI judgment of 6 June 2002, in Case T-342/99, *Airtours v Commission*, ECR 2002, p. II-2585. *ECLI:EU:T:2002:146*). Currently, it is debatable whether the gap in question had indeed been filled (A. Heimler. (2008). *Was the change of the Test for Merger Control in Europe Justified? An Assessment (Four Years After the Introduction of SIEC*), European Competition Journal, Vol. 4 (1), pp. 85-93).

2. THE SIEC TEST IN MERGER ASSESSMENT

Under the first regulation, the dominance test was interpreted by the CFI (the Court of First Instance) in cases: *Kali und Salz/MDK* (CFI judgment of 25 October 2002 in Case T-5/02 *Kali und Salz/MDK*, ECR 1998, p. I-1375), *Gencor* (CFI judgment of 3 June 1997 in Case T-102/96 *Gencor v Commission*, ECR 1999, p. II-753, *ECLI:EU:T:1999:65*), and *Airtours* (CFI judgment of 6 July 2002 in Case T-342/99 *Airtours v Commission*, ECR 2002, p. II-2585. *ECLI:EU:T:2002:146*) where not only individual, but also collective dominance (where the dominant position is held jointly by more than one undertaking) was relevant. The CFI demonstrated that the dominance test is applied in cases where the merged undertaking will not become a market leader, but will constitute a part of an oligopoly (Great Britain was in favour of a test that would find a concentration incompatible with the internal market if there was a likelihood of a serious restriction of competition in the internal market or in its significant part. Germany, on the other hand, claimed that there was no significant difference between the dominance test and the SLC test, neither in theory nor in practice. Therefore, Germany was in favour of the dominance test. In the end, the Council adopted a compromise between Germany's preference for the dominance test and Great Britain's preference for the SLC test). The currently applied SIEC test fills the earlier jurisdiction gap, without eliminating dominance as the key merger assessment criterion. Implemented in 2004, it still constitutes an essential tool for assessment of concentration operations by the European Commission, in cases where the transaction has been notified to the Commission. The main factor, determining whether a concentration is notifiable, is the turnover threshold defined in Art. 1 of the Regulation No 139/2004. All concentration transactions reported to the Commission are assessed based on the above-mentioned SIEC test. The test verifies whether or not a concentration will result in a significant distortion of competition, in particular through the creation or strengthening of a dominant position of the merged undertakings. The test is not limited to predicting whether the merger will result in a possible abuse of a dominant position, but considers also other distortions of competition, which are primarily the coordinated effects, associated with collective dominance, and unilateral effects (Commission Decision on 19.02.2008 COMP/M.4726 – *Thomson Corporation/Reuters Group*, para. 275).

3. COORDINATED VERSUS NON-COORDINATED EFFECTS

An oligopolistic structure entails strategic actions taken by a small group of undertakings whose business tactics take into account the behavior of their competitors. Undertakings present in the market generally do not implement any effective competitive strategies without considering competitive behavior. Both coordinated and non-coordinated (unilateral) effects are a key problem in the assessment of concentration transactions by the European Commission in the light of Art. 2 (3) and (4) of the Regulation No 139/2004, and were the underlying premise for the construction of those regulations. The two types of spill-over effects differ in terms of the way in which competitive behavior in the relevant market is taken into account. In the case of non-coordinated effects (individual shaping of market behavior) undertakings treat the behavior of competitors as data that cannot be influenced. However, the market structure may be conducive for them to raise prices above the level set by the market. Coordinated effects, on the other hand, occur where undertakings act with an intention to influence the behavior of their competitors. These effects are most frequent in case of horizontal mergers, as they affect market structure by reducing the intensity of rivalry between the parties to the transaction. In such situations, there is a risk that the undertakings may be able to behave in a coordinated way, even without entering into an agreement contrary to Art. 101 (1) of the TFEU. Such coordination may concern e.g. the level of prices, the volume of production, capacity, market division or contracts awarded through tenders (Guidelines on the assessment of horizontal mergers, pts 39-40; M. Ivaldi, B. Jullien, P. Rey, P. Seabright, J. Tirole, (2003). *The Economics of Tacit Collusion*. European Commission. Idei Touluse, p. 26). In the Guidelines on the assessment of horizontal mergers, the Commission indicates that the structure of certain markets may facilitate the coordination of prices (Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings OJ 2004, C 31/3, pt. 39). Firms will consider it possible, economically rational and hence preferable, to raise the prices. Coordinated effects arise in particular due to the creation or strengthening of a collective dominant position following a concentration (F. Dethmers. (2005). *Collective dominance under EC merger control – after Airtours and the introduction of unilateral effects is there still a future for collective dominance*? ECLR, 26 (11), pp. 638-639).

The concept of non-coordinated effects assumes that horizontal mergers in oligopolistic markets with heterogeneous products may lead to higher prices, if the concentration results in an increase in the prices of the merged undertakings. In the Guidelines on the assessment of horizontal mergers, the Commission points out that such a merger may significantly distort effective competition, by lessening the competitive pressure of one or more undertakings, who consequently have increased market power, without the need to coordinate their competitive behavior (without coordinated effects). Non-coordinated effects arise also when the reduction of competitive pressure between the parties to a concentration makes it profitable for them to increase prices.

4. ASSUMPTIONS OF THE CONCEPT OF UNILATERAL EFFECTS

Unilateral effects occur mainly where a horizontal concentration results in the creation or strengthening of a dominant position of a single undertaking (G. J. Werden. (2008). *Unilateral Competitive Effects and the Test for Merger Control*, ECJ, Vol. 4, No 1, pp. 95-103). They may also arise in the absence of individual dominance of a single undertaking. According to the Commission, unilateral effects may occur primarily in oligopolistic markets (Guidelines on assessment of horizontal mergers, pts 25-29; Commission decision on 24.04.1996 IV/M.619 *Gencor/Lonrho*, OJ 1997, L. 11/30, pt. 141), due to their high transparency. Such effects may arise even in situations where no coordinated effects (or tacit collusion) occur, if concentration eliminates competitive pressure (Commission decision on

20.11.2009 COMP/M.5549 *EDF/Segebel*, OJ 2010, C 57/5. In this case, the Commission pointed out that even though the merger will not result in the creation or strengthening of a dominant position, the SIEC test will be satisfied as the transaction will lessen the competitive pressure. The new rival will not be willing to compete). This causes an increased market power of the parties to concentration, or an increase in prices (Guidelines on the assessment of horizontal mergers, pt. 24). Unilateral effects may also take the form of non-collusive oligopoly, i.e. a situation where the undertakings remaining in the market after the concentration are able to use their market power and thus to increase the prices, even if there is little likelihood of coordination of competitive behavior between them and they are not dominant individually (G. J. Werden, p. 95-103).

In accordance to Guidelines on the assessment of horizontal mergers: "A merger may significantly impede effective competition in a market by removing important competitive constraints on one or more sellers, who consequently have increased market power" (Guidelines on the assessment of horizontal mergers, pt. 24). The most direct effect of a merger will be the loss of competition between the merging firms (J. Faul, A. Nikpay (ed.). (2014). *The EU Law of Competition*, Third Edition, Oxford, pp. 695-699). In other words, the Commission may prohibit a concentration which does not result in the creation or strengthening on an individual or collective dominance, if the fact of elimination of one undertaking from the market may significantly impede competition. Therefore, unilateral effects are defined as a change in the market structure, caused by a concentration and having a negative impact on consumers.

5. BEHAVIOR OF UNDERTAKINGS ON THE MARKET IN THE LIGHT OF THE CONCEPT OF UNILATERAL EFFECTS

Unilateral effects following a concentration are identified with a change in the market structure. The concept of unilateral effects examines whether a concentration leads to a change in competitive behavior of undertakings on the relevant market. It has been developed on oligopolistic markets where undertakings, in their efforts to maximize profits, formulate their business strategies taking into account the reactions of their competitors.

In its simplest, static form, the theory of oligopoly refers to market conditions, which includes in particular prices and production volumes in various types of competition (price competition, competition regarding production capacity and marketing competition), as well as the degree of product differentiation, cost differentiation, barriers to entry, access to products, number of undertakings in the market etc. In an oligopolistic market competitors are collectively (jointly) interested in the coordination of their actions with a view to restrict supply and raise prices up to a level that guarantees the expected profits. Economic literature indicates reasons due to which undertakings may find such coordination difficult. One of the most frequent reasons is a strong incentive to increase a firm's own profit individually, if the behavior of its competitors makes it possible. Such assumptions are made by Cournot and Bertrand, the authors of static oligopoly models. On the other hand, authors of dynamic competition models (e.g. Sweezy) predict that there is a likelihood of coordination if certain firms have been on the market for a relatively long time and if they enter into repeated interactions frequently enough, at more or less regular intervals (Ch. Vorster. (2012). *Die Anwendung des SIEC-Tests auf Imitation und Kollusion im Oligopol*, Nomos, Bonn, pp. 128-129. Dynamic efficiency is related to the ability for innovation, development of new technologies and by the same, expanding production possibilities). In such circumstances, the strategy of setting high prices based on the principle "I will raise prices if you do, and I will lower prices if you do" allows firms to achieve prices and profits higher than they would be able to achieve in the simple, static competition model Literature indicates the presumption of coordination or tacit collusion as a possible effect of dynamic competition (R. Posner takes

the view, that from the economic perspective it is irrelevant whether a price collusion plan has been developed in a manner producing any evidence. If seller A limits its production, anticipating seller B to do the same, and B will actually limit its production too, then we are dealing with mutual understanding, even though there are no clear indications of communication. By refraining from pursuing short-term profit, each of them may earn a monopoly profit. See R. Posner. (2000), *Antitrust Law*, 2nd edn, Chicago, University of Chicago Press, 94-95). This theory implies the possibility of only a certain degree of coordination with full market transparency.

6. THE PRICE INCREASE CRITERION

The concept of unilateral effects assumes the existence of a correlation between market structure and prices, which may be measured with the Lerner index (it indicates the degree of market power). The Lerner index confirms that every concentration leads to a slight increase in prices. With each such transaction, the number of undertakings on the market is reduced by at least one. In terms of the possibility of price increase, it does not matter whether the number of entities is reduced from four to three or from ten to nine. With each concentration, the occurrence of unilateral effects must be taken into account, although the impact they exert will obviously differ (U. Schwalbe. (2006). *Nicht koordinierte Effecte horizontaler Zusammenschlusse – wirtschaftsteoretische Grundlagen und Prognose durch Simulationsmodelle* /in:/ Recht und Wettbewerb: Festschritt für Reiner Bechtold zum 65. Geburtstag, I. Brinker, D. Scheuing, K. Stockmann (ed.), Munich, p. 479; S. Bishop, D. Ridyard. (2003). *Prometheus unbound: Increasing the Scope for Intervention in the EC Merger Control*, ECLR, No. 8, p. 357-363).

The ability to elevate prices above the level of total costs depends on the market structure and the elasticity of demand. Therefore, the situation in the market can be modeled depending on its structure (market share has influence on prices). In consequence, in monopolistic markets the price increase is the largest, while in the conditions of perfect competition it is the lowest and close to zero. In oligopoly, similarly as in monopoly, a certain increase in prices will occur. This means that each horizontal concentration is followed by a price increase and the merged parties may demand higher prices. The above applies to situations where products are homogeneous. With heterogeneous products, the common price increase after a concentration is on the same, or even higher level, if the individual elasticity of demand for products manufactured or sold by the parties to concentration is similar or if it decreases as a result of the merger. Therefore, the concept of unilateral effects is not based on the growth of market share, but shows to what extent the execution of a concentration affects the elasticity of demand for products manufactured (sold) by parties to the transaction in relation to their market partners. For instance, if a market has five competitors: A, B, C, D, E and F, and competitors A and B decide to merge, the new combined company AB raises the price of product A. This may cause some customers to stop buying product A. Such customers will switch to a competitor's product or may even resign from purchasing the product. Some of the customers who switch to substitutes will purchase product B, which means that the fall in profits of the merged firm will be less severe. Profits from sales of product B will be internalized by the merged company AB, so the turnover of the merged company AB will not be significantly lower. This is an incentive for AB to raise the price of product A after the merger. Price increase and other effects occurring after a concentration (e.g. reduction of production volume or product range, degradation of product or service quality, limitation of the innovation level) are profitable irrespective of whether the competitors act in collusion, i.e. they are consequences of the so-called non-coordinated effects (Commission Decision on 19.02.2008 COMP/M.4726 – *Thomson Corporation/Reuters Group*, para. 275). If the merged company AB notices an increase in demand for product B, it will raise also the price of

product B. The tendency to raise prices will occur also among other firms in the relevant market (i.e. among the competitors). This tendency results from the fact that due to the price increase the customers of A and B change the source of supply and switch to companies C, D and E. This, in turn, causes an increase in demand for products of the competitors and, in effect, a greater tendency of the remaining competitors to raise their prices. This means a reduction of competitive pressure between firms operating on the relevant market, which will eventually lead to a price increase.

From an economic point of view, each horizontal concentration may result in a price increase. However, it is difficult to estimate to what extent the prices may rise, as there are numerous factors that curb the risk of price increase. The tendency to increase prices will be reduced if a certain level of rivalry is maintained in the market (Commission Decision on 13.11.2006 COMP/M.4297 – *Nokia/Siemens*, para. 88). If the concentration between A and B leads to an increased efficiency, e.g. due to a transfer of know-how or the scale effect, the merged undertaking is less inclined to raise prices, because it may obtain a higher profit margin without an increase. In addition, the merged undertaking will not raise prices while the other competitors are repositioning their products in the market or introducing innovations. The same effect occurs when entry barriers are low and the risk of a new entry increases the competitive pressure among the existing competitors. The concept of non-coordinated effects assumes that a concentration is followed by a decrease in competition in the relevant market. It illustrates the paradigm of the relationship between the market structure and the behavior of undertakings after a concentration. According to this concept, every merger causes a reduction in rivalry, which results in specific behaviors (raising prices by parties to the transaction and by the competitors).

7. TOOLS FOR ANALYSIS OF NON-COORDINATED EFFECTS

The study of non-coordinated effects, i.e. effects due to which a merger causes a shift in market balance, requires an analysis of the changes in levels of sales of the parties to concentration after the transaction (initial effect of internal coordination), analysis of the reaction of competitors to the behavior of the parties involved in the concentration (feedback), and an assessment of the overall impact on competition in the relevant market.

Pursuant to Art 2 (3) of the Regulation 139/04 which defines the manner of assessment of concentrations, namely the SIEC test, the assessment is not limited only to the prediction of the possible price increase. A key element in the assessment of concentrations based on the SIEC test is the significant impediment of effective (dynamic) competition. Therefore, it is essential to assess whether after the transaction there will be competitive pressure in the market between rivals.

The main tool for illustrating competitive pressure is the cross-price elasticity of demand (M. Ivaldi, B. Jullien, P. Ray, P. Seabright, J. Tirole, p. 61). It may be calculated if there is access to financial statements and to information on changes in customer behavior in response to the increase in prices. Such information, however, is limited (M. Ivaldi, B. Jullien, P. Ray, P. Seabright, J. Tirole, p. 76, 94). In practice, serious problems arise in case of heterogeneous products, which are difficult to compare. Market behaviors are not covered by one-dimensional functions of demand, but by a simulation of market processes, in respect of which the available data differ. Demand may be illustrated by various demand models (M. Ivaldi, B. Jullien, P. Ray, P. Seabright, J. Tirole, p. 91). Which simulation models will be applied, often depends on the available data. Therefore, it is difficult to distinguish whether effective competition will be significantly impeded by the concentration, or whether the remaining competition is effective.

The concept of non-coordinated effects should include price and quantity effects of mergers and should cover concentrations where:

- parties to concentration are close competitors (because they offer close substitutes) (Guidelines, pt. 28),
- Customers have limited choice (there are few undertakings offering similar products) (Guidelines, pt. 31)
- the capacity of competitors is limited and they are not able to compensate for an increase in prices or a decrease in supply (pt. 32),
- parties to concentration may hinder the expansion of smaller competitors, e.g. through the control of factors (conditions) for entry (pt. 36), which is also important in case of vertical concentration,
- concentration eliminates a significant competitive force, e.g. a significant innovator or access to the market (pts. 37-38).

The economic model requires an assessment of whether the price increase will be significant. In practice, it is very broad, unlimited, and may justify the prohibition of any concentration in the oligopoly. Such a broad application goes beyond Art. 2 (2) of Regulation 139/04, pursuant to which the Commission must permit concentration transactions which cause no significant impediment of competition.

8. APPLICATION OF THE CONCEPT OF NON-COORDINATED EFFECTS IN PRACTICE

The concept of unilateral effects should not be applied to assess concentrations in oligopolistic markets, as it does not take into account the oligopolistic interdependence. The concept describes only a single oligopolistic reaction to the price increase after a concentration, but does not include oligopolistic reaction in the process of competition. It does not allow to differentiate a significant impediment of competition from its insignificant disturbance, which could be helpful in terms of legislative formalization. Thus, the concept fails to include the mutual dependence of oligopolists and the dynamics of competition. The reaction of competitors is judged based on the static oligopoly model (Cournot's or Bertrand's), which studies the reactions of competitors to the behavior of their rivals, but does not anticipate their behavior.

Models developed by Cournot and Bertrand assume a lack of cooperation between undertakings in oligopoly (They are statistical models in which the Nash equilibrium results from lack of cooperation. See M. B. Coate, J.H. Fisher. (2012). *Why can't we just get along? Structural Modeling and Natural Experiments in Merger Analysis*, ECJ, Vol. 8, No. 1, p. 54.). These models can be helpful in the assessment of competition between suppliers of close substitutes, when, for instance, they have access to the same technology. They make it possible to predict the relationships between multiple undertakings and their average level of profit. They both assume that profits are lower than they would be in a situation where firms could fully coordinate their market policy (as is the case in a cartel).

However, from the perspective of analysis of effects of concentration in a market, their usefulness is limited. The static oligopoly model takes into account only the first reaction of competitors, without studying the feedback or the dynamics (Ch. Kirchner. (2006). *The Development of European Community Law in the Light of New Institutional Economics*, /in:/ *Institution in Perspective. Festschrift in Honor of Rudolf Richter on the Occasion of his 80th Birthday*, U. Bindseil, J. Haucap, Ch. Wey (ed.), Tübingen, p. 318. He criticizes the SIEC test with regard to the concept of unilateral effects, claiming that the cross-price elasticity of demand does not account for any dynamic effects). Also, a progressive analysis of indirect effects of concentrations is not a dynamic analysis. Since the concept of unilateral effects does not take into account the interdependence of oligopolists, it does not reflect the real situation in an oligopolistic market (S. Wrase. (2007). *Europäische Fusionkontrolle. Der*

Oligopoltatbestand unter besonderer Berücksichtigung der Unilateralen Effecte, Baden-Baden, p. 76, 86).
It is based on unclear and vague assessment criteria and makes it impossible to predict the Commission's decision. It is difficult to foresee the behavior of customers and state whether they will choose products supplied by the competitors. Therefore, undertakings are unable to predict which concentrations will be prohibited by the Commission. They are not able to anticipate the Commission's decision, but they are under the obligation to notify it of the intention of concentration. This leads to a lack of legal certainty and unpredictable transaction costs for parties to concentration (the participating undertakings - Ch. Kirchner. (2010). SIEC-Test für die Deutsche Fusionkontolle? Wirtschaft und Wettbewerb, No. 1, p. 3).

9. CONCLUSION

In the initial period of merger control, the test for an abuse of dominant position was used as the main tool in assessment of concentrations. When examining a concentration, there was a strong focus on the proportion of market share held by the parties participating in the transaction in question. Currently, concentrations are assessed in terms of risk of distortion of competition, other than only the creation or strengthening of dominance. Such risk includes, among others, unilateral effects.
The concept of unilateral effects assumes that every concentration leads to certain price-related effects (U. Schwalbe. (2006). p. 479.; S. Bishop, D. Ridyard. (2003). *Prometheus unbound: Increasing the Scope for Interwention in the EC Merger Control,* ECLR, No. 8, pp. 357-363). Assessment of concentrations is not limited to studying the potential likelihood of a post-merger price increase, but includes also other broadly understood effects of the transaction. The SIEC test uses the notion of significant impediment of effective competition. Therefore, it focuses not only on the price effect, but also on other possibilities of distortion of competition, such as restriction of offer or restriction of innovation. The concept of unilateral effects, however, does not take these aspects into account. Therefore, from practical perspective, it is limited to the price effect and does not permit an accurate assessment of the impact of concentration on the relevant market. Moreover, there is no clarity as to the precise moment when one may declare that due to an increase in prices, effective competition has been significantly impeded.
As a consequence, decisions of the Commission are difficult to predict and there is uncertainty among entrepreneurs with regard to the possibility of execution of concentration transactions. It is hard to estimate whether the Commission will grant its consent for execution of a contemplated concentration.

ACKNOWLEDGEMENT: *The publication was financed by the National Science Centre (Decision Nr DEC-2014/15/B/HS5/00689).*

LITERATURE:

1. Bishop S., Ridyard D. (2003). *Prometheus unbound: Increasing the Scope for Interwention in the EC Merger Control,* European Competition Law Review. Nr 8. p. 357-363.
2. Case T-102/96 *Gencor v Commission,* ECR 1999, II-753
3. Case T-342/99 Airtours v Commission, ECR 2002, II-2585.
4. Case T-5/02 *Kali und Salz/MDK*, ECR 1998, I-1375.
5. Coate M. B., Fisher J.H. (2012). *Why can't we just get along? Structural Modeling and Natural Experiments in Merger Analysis*, European Competition Journal. Vol. 8, Nr 1.
6. Commission decision on 03.08.2006 COMP/M.4141 *Linde/BOC,* OJ C 181/13
7. Commission Decision on 13.11.2006 COMP/M.4297 – *Nokia/Siemens*. OJ 2007, C 9/06.

8. Commission Decision on 19.02.2008 COMP/M.4726 – *Thomson Corporation/Reuters Group*, OJ 2008 C 212/04.
9. Commission decision on 24.04.1996 IV/M.619 *Gencor/Lonrho*, OJ 1997, L. 11/30, para. 141. Commission decision on 20.11.2009 COMP/M.5549 *EDF/Segebel*, OJ 2010, C 57, s. 5.
10. Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ 2004, L 24/1
11. Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, OJ 1990, L 257/13
12. Dethmers F. (2005). *Collective dominance under EC merger control – after Airtours and the introduction of unilateral effects is there still a future for collective dominance*? European Competition Law Review. Vol. 26 (11), p. 638-639.
13. Faul J., Nikpay A. (2014). *The EU Law of Competition*. Third Edn, Oxford University Press.
14. Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings OJ 2004, C 31/3, para. 24.
15. Heimler A. (2008). *Was the change of the Test for Merger Control in Europe Justified? An Assessment (Four Years After the Introduction of SIEC*), European Competition Journal, Vol. 4 (1), p. 85-93.
16. Ivaldi M., Jullien B., Ray P., Seabright P., Tirole J. (2003). *The Economics of Tacit Collusion*. European Commission. Idei Touluse. Retrieved: 20.03.2017 from: http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_tacit_collusion_en.pdf
17. Kirchner Ch. (2006). *The Development of European Community Law in the Light of New Institutional Economics*. In: *Institution in Perspective. Festschrift in Honor of Rudolf Richter on the Occasion of his 80th Birthday*, Bindseil U., Haucap J., Wey Ch. (ed.). Tübingen.
18. Kirchner Ch. (2010). SIEC-Test für die Deutsche Fusionkontolle? Wirtschaft und Wettbewerb. Nr 1.
19. Posner R. (2000). *Antitrust Law*, 2nd edn, Chicago. University of Chicago Press.
20. Röller L. H., Friederiszick H. (2005). *Ökonomische Analyse in der EU Wettbewerbspolitik*. Baden-Baden. Retrieved: 23.01.2017 from: http://ec.europa.eu/competition/speeches/text/sp2005_012_de.pdf
21. Schmidt I. (2007). *The Suitability of the More Economic Approach for Competition Policy: Dynamic v Static Efficiency*. European Competition Law Review. p. 408-411
22. Schwalbe U. (2006). *Nicht koordinierte Effecte horizontaler Zusammenschlusse – wirtschaftsteoretische Grundlagen und Prognose durch Simulationsmodelle*. In: Recht und Wettbewerb: Festschritt für Reiner Bechtold zum 65. Geburtstag, Brinker I., Scheuing D., Stockmann K. (ed.), Monachium.
23. Tyson N. (2007). *Joint Ventrue Regulation under European Competition Law: An Update*. European Law Journal. Vol. 13 (3). p. 408-418.
24. Vorster Ch. (2012). *Die Anwendung des SIEC-Tests auf Imitation und Kollusion im Oligopol*. Bonn. Nomos.
25. Werden. G. J. (2008). *Unilateral Competitive Effects and the Test for Merger Control*, European Competition Journal, Vol. 4, Nr 1, p. 95-103.
26. Wrase S. (2007). *Europäische Fusionkontrolle. Der Oligopoltatbestand unter besonderer Berücksichtigung der Unilateralen Effecte*, Baden-Baden.

LEGAL REQUIREMENTS FOR CROATIAN MARINAS ACCORDING TO EUROPEAN STANDARDS FOR THE PORT WASTE FACILITIES

Zeljka Primorac
Faculty of Law University of Split, Croatia
zeljka.primorac@pravst.hr

Mara Barun
Faculty of Law University of Split, Croatia
mbarun@pravst.hr

Bozena Bulum
Adriatic Institute, Croatian Academy of Sciences and Arts, Croatia
bbulum@hazu.hr

ABSTRACT

The authors of this article analyze the European and Croatian legal solutions achieving effective management of marine waste in Croatian marinas, ports of nautical tourism. It was carried out a comparison of legal norms regarding the availability and use of port waste facilities in the Croatian subordinate legislation regulating the conditions to be met by the port in order to protect the marine environment from pollution (Decree on conditions to be met from the port of 2004); lays down minimum requirements to be met by the marina in relation to infrastructure and waste management (Regulation on the classification and categorization ports of nautical tourism from 1999; Regulation on the classification and categorization ports of nautical tourism from 2008) and transferred solutions Directive 2000/59/EC on port reception facilities for ship-generated waste in the legal system of the Republic of Croatia (Regulation on the conditions and method of maintaining order in ports and on other parts of internal waters and territorial sea of the Republic of Croatia from 2017). The authors have analyzed the national strategic documents (Study on Nautical Tourism Development 2015; Strategy for Maritime Development and Integrated Maritime Policy of the Republic of Croatia for the period 2014-2020; Tourism Development Strategy for the Republic of Croatia 2020; Croatian Nautical Tourism Development Strategy 2009-2019; Strategy for Sustainable Development of the Republic of Croatia from 2009 etc.) and European strategic guidelines (Evaluation of Directive 2000/59/EC on port reception facilities for ship-generated waste 2016; Guidelines for the interpretation of Directive 2000/59/EC from 2016 etc.) that emphasize the necessary improvement in the availability and use of port facilities for the reception of ship waste in order to improve protection of the marine environment. Pointing to the EMSA studies which shows that in 55% of the EU Member States waste reduction plans have not been developed or implemented (in particular and recreational ports), the authors point to the duty of EU Member States provide an appropriate legal framework for the proper functioning of the port reception facilities and marina operator's liability in equipping marinas with appropriate port reception facilities and equipment for the reception of ship waste by ensuring their availability, suitability and simplicity of use.

Keywords: *Croatian Marinas, Legal Requirements, Port Waste Facilities*

1. INTRODUCTION

For the oceanographic terms of maritime navigation, Mediterranean Sea (also Adriatic Sea as sub-region of Mediterranean Sea) is considered to be so-called specific area with vulnerable maritime eco-system. Scientific and technological development of maritime traffic guarantees

safe, energetically efficacious and ecologically acceptable type of transport. Nevertheless, maritime transport sector contributes substantially to the presence of oily waste, sewage and garbage in the marine environment (Report from the Commission to the European Parliament and the Council - Evaluation of Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues, 2016, p.5.). On average 20% of marine litter (garbage) in the marine environment is of ship-based origin (Report from the Commission to the European Parliament and the Council, Evaluation of Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues, 2016, p.6.).

2. EUROPEAN LEGAL SOLUTIONS FOR ACHIEVING EFFECTIVE MANAGEMENT OF MARINE WASTE IN MARINAS

The continuous development of European nautical tourism is supported by the fact that Europe has more than 70.000 km of coastline and as the world'a leading yachting destination has more than 4.500 marinas for about 6.3 million recreational crafts (Institute for Tourism, 2015, p.12). The intensified demand for faster and more attractive recreational vessels – vessels for sport and recreation, together with development of nautical tourism as a "multidisciplinary touristic activity with expressed maritime component" (Luković, 2012, p.280) and driver of economic development, also indicated on negative consequences of faster development of maritime tourism – larger sea and coast contamination by waste from recreational vessels. As the illegal release of water, oil and other waste from mentioned vessels into the sea became regular (Davenport; Davenport, 2006, p.282-283), it is necessary to improve the protection of maritime environment. As the Adriatic Sea is close, the measures of protection of marine environment within port areas take the more important role, and also direction of European strategies for preventing waste production and throwing from ships into the sea as support to sustainable seashore, maritime and nautical tourism.

2.1. Protection of the marine environment within ports areas (marinas) according to Directive 2000/59/EC

Ports play an increasing role for transfer of goods and passengers to the environmentally less damaged, less costly and less congested maritime transport having an essential contribution to the efficient use of maritime transport infrastructure (Güler; Sağ, 2014, p.2). For achieving a greener maritime transport enhancing the protection of the marine environment a key instrument is implementation of the solutions Directive on port reception facilities for ship-generated waste and cargo residues (Directive 2000/59/EC) in national legislation system EU Member States. Directive 2000/59/EC was passed on the 27th of November 2000 by European Parliament and Council in order to reduce releasing ship-generated waste into the sea. According to Art.2.c) Directive 2000/59/EC releasing a ship-generated waste means releasing all waste, including sewage, and residues other than cargo residues, which are generated during the service of a ship and fall under the scope of Annexes I, IV and V to MARPOL 73/78 and cargo-associated waste as defined in the Guidelines for the implementation of Annex V to MARPOL 73/78. Directive 2000/59/EC transposes MARPOL'S requirements into EU Community law (Hoenders, 2012, p.16). Pursuant to Art.2.1.h) Directive 2000/59/EC the same is applied onto the ports (a place or a geographical area made up of such improvement works and equipment as to permit, principally, the reception of ships, including fishing vessels and recreational craft) EU Member States as well to ports wherein recreational crafts sale into. Pursuant to disposition of Art.3. of Directive 2000/59/EC, the same is applied to recreational craft (a ship of any type, regardless of the means of propulsion, intended for sports or leisure purposes -Art.2.1.g) Directive 2000/59/EC) regardless the flag they wave, and which put to shore in port of EU Member

States or navigate within a port of EU Member States. Consequently, it is obvious the application of solution of Directive 2000/59/EC on marinas as the most important ports of nautical tourism. Marina is the specialized port or contemporary settled and waves protected maritime zone for necessities of nautical tourism and recreation, the dominating type of touristic port in the world (Luković; Bilić, 2007, p.116). In Europe are about 4.400 salt water marinas and more than 1.600 are of high quality with more than 400.000 berths that meet the highest standards. (Kizielewicz; Luković, 2013., p.463). Directive 2000/59/EC aims to reduce of ship-generated waste and cargo residues into the sea by improving the availabillity and use of dedicated reception facilities in the EU ports (ESPO views on the revision of Directive 2000/59/EC on Port Reception Facilities for ship-generated waste and cargo residues, 2016, p.1). Directive focuses on ship operations in Community ports and addresses in detail the legal, financial and practical responsibilities of the different operators involved in delivery of waste and residues in ports stating that Member States must ensure that port collection facilities are provided which meet the needs of the ships using them without causing abnormal delays (Güler; Sağ, 2014, p.6). One of the European Union's key port policies is quality services in sea ports – improvement and modernization of port's infrastructure (Güler; Sağ, 2014, p.2). It is the duty of EU state-member to insure in all ports of EU an adequate legal frame for appropriate functioning of port reception facilities ie. any facility, which is fixed, floating or mobile and capable of receiving ship-generated waste or cargo residues (Art.2.2. Directive 2000/59/EC). That leaves the EU Member States with a high degree of freedom to arrange the reception of waste in the most suitable manner and permits them, inter alia, to provide fixed reception installations or to appoint service providers bringing to the ports mobile units for the reception of waste when needed (preambula pod 10). For a port reception facility to be considered adequate, the facility should be available during a ship's visit to the port, be conveniently located and easy to use (Guidelines for the interpretation of Directive 2000/59/EC on port reception facilities for ship generated waste and cargo residues, 2016, p.6). According to Horizontal Assessment Report from 2010 on port reception facilities, almost all EU Member States have port reception facilities that are adequate and available and responsibilities for ensuring the availability and adequacy of port reception facilities had usually been delegated to port authorities/operators irrespective of the port type. To ensure availability, port reception facilities shall be capable of receiving the types and quantities of ship-generated waste and cargo residues from ships normally using that port, taking into account the operational needs of the users of the port (Art. 4.2. Directive 2000/59/EC). From this legal norm derives an uncertainty of reading the concept of “ships normally using that port“. That is, by legal reading the subject formulation would mean that ports will not be required to provide facilities for vessels that are, for example, forced to tie up on their quayside because of bad weather (Carpenter; Macgill, 2003, p.21). Art.5.1 Directive 2000/59/EC prescribes the obligation of elaborating a appropriate waste reception and handling plan – WRH Plan for all ports of the Member States normally visited by fishing vessels and recreational craft. For each port shall be developed and requirements for WRH Plans. They are set out in Annex I Directive 2000/59/EC. According to Annex I Directive 2000/59/EC plans shall cover all types of ship-generated waste and cargo residues originating from ships normally visiting the port and shall be developed according to the size of the port and types of ships calling at the port. The following elements shall be addressed in the plans: a) an assessment of the need for port reception facilities, in light of the need of the ships normally visiting the port; b) a description of the type and capacity of port reception facilities; c) a detailed description of the procedures for the reception and collection of ship-generated waste and cargo residues; d) description of the charging system; e) procedures for reporting alleged inadequacies of port reception facilities; f) procedures for ongoing consultations with port users, waste contractors, terminal operators and other interested

parties; and g) type and quantities of ship-generated waste and cargo residues received and handled. In addition, the plans should include: a) a summary of relevant legislation and formalities for delivery; b) identification of a person or persons to be responsible for the implementation of the plan;c) a description of the pre-treatment equipment and processes in the port, if any; d) a description of methods of recording actual use of the port reception facilities; e) a description of methods of recording amounts of ship-generated waste and cargo residues received; and f) a description of how the ship-generated waste and cargo residues are disposed of. The WRH Plan can be regional in nature covering numerous ports, combining the essential elements of a plan for more than one port or terminal into one regional plan (Technical Recommendations on the Implementation of Directive 2000/59/EC on Port Reception Facilities, 2016, p.6). The WRH Plans may vary significantly in detail and coverage, from a large commercial port to a small fishing port or marina (Guidelines for the interpretation of Directive 2000/59/EC on port reception facilities for ship generated waste and cargo residues, 2016, p.8). The development and evaluation of the WRH Plans is considered an issue for a large number of smaller ports, which often lack the resources to draft detailed plans covering all the aspects as required in the directive so EMSA studies shows that in 55% of the Member States WRH Plans have not been developed or implemented in particular in fishing and recreational ports, and in a smaller number in small commercial ports (Report from the Commission to the European Parliament and the Council - Evaluation of Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues, 2016, p.8). Against states which did not fulfill the aforesaid obligations pursuant to Directive 2000/59/EC, European Commission has started the procedure at Court of Justice of the European Union (ECJ). According to the ECJ Finland, Greece, France Italy and Spain have breached Directive 2000/59/EC by failing to develop, implement and approve WRH Plans for all ports (Commission v Finland C-523/06; Commission v Greece C-81/07; Commission v France C-106/07; Commission v Italy C-368/07; Commission v Spain C-480/07).

3. CROATIAN LEGAL SOLUTIONS FOR ACHIEVING EFFECTIVE MANAGEMENT OF MARINE WASTE WITHIN PORT AREAS

Strategic goal of Croatia as the most important nautical destination in Europe by all means has to be searched in ecologically sustainable satisfaction of needs of recreational segment of maritime traffic in function of nautical tourism (Strategy for Maritime Development and Integrated Maritime Policy of the Republic of Croatia 2014-2020, 2014, p.5) and, regarding that Croatia effectuates sovereignty on app. 12.2% of coastal strip and on 33% of coastal strip in Mediterranean, the subject is natural potential of Croatia for nautical tourism development (Croatian Nautical Tourism Development Strategy 2009-2019, 2009, p.8.). In segment of maritime traffic of recreational vessels, beside 120.000 boats and yachts of Croatian flag in maritime traffic, there are also 60.000 foreign boats and yachts annually so that the intensified development of nautical tourism has negative effects which manifest themselves especially through quantity of waste and fecal waters (Strategy for Maritime Development and Integrated Maritime Policy of the Republic of Croatia 2014-2020, 2014, p. 19.). Strategy for Sustainable Development of the Republic of Croatia from 2009 as and Strategy for Maritime Development and Integral Maritime Policy of the Republic of Croatia 2014.-2020. prescribe that the main goal of protection of Adriatic Sea, coastal area and islands of Republic of Croatia is expressed in establishment of effective (sustainable) system of reception of waste from ships and equipping the nautical tourism ports with adequate facilities and equipment for their reception.

Application of ecologic standards, promotion and improvement of collection system of solid waste from boats and yachts are some of measures that have to contribute to achievement of goal which is in that until year 2020 Republic of Croatia should be the most desirable yachting destination in the Mediterranean (Tourism Development Strategy for the Republic of Croatia 2020, 2013, p.38).

3.1. Protection of the marine environment within croatian marinas according to Directive 2000/59/EC

In year 2006 the number of nautical tourism ports in Republic of Croatia was increased for 11.3% (Luković; Bilić, 2007, p.122). Until year 2010 in Republic of Croatia was in business 98 ports of nautical tourism (50 marines with berths in sea, 10 marines with berths ashore and 38 of other nautical tourism ports), then their number in last ten years has been increased for almost 50% (Master Plan and Tourism Development Stratey of the Republic of Croatia, 2011, p.102). In the same manner, increased also total realized nautical tourism ports' income, as data of Croatian Bureau of Statistics showed that total realized income of nautical tourism ports in 2015 was 753 million HRK (app. 90 millions of euro), that is for 5.1% more comparing to year 2014 (Croatian Bureau of Statistics, 2016, p.1). But weaknesses of yachting tourism in Croatia are in lack of legal prescriptions' coordination, inappropriate categorization of nautical tourism ports, inappropriate waste disposal, inefficient system of environment protection (Institute for Tourism, 2015, p.21).

By implemental regulations nautical tourism ports commit themselves to implement the system of reception facilities for waste collection from crafts (feces, oils, utility waste) whereat is, respecting the world ecologic standards, efficiently contributed to environment sustainment (Croatian Nautical Tourism Development Strategy 2009-2019, 2009, p.22). By Decree on condition to be met from the port of 2004 (Decree) the terms are prescribed whereat ports have to comply in order to enable protection of sea from contamination. Nautical tourism ports as ports for special purposes must have reception facilities capable for reception of varieties and quantities of liquid and solid waste, depending on the following: types and sizes of crafts which normally use the port, size and geographic position of port (Art. 3.1.6. Decree). By Regulation on the conditions and method of maintaining order in ports and on other parts of internal waters and territorial sea of the Republic of Croatia 2005-2017 (Regulation) it was transmitted the Directive 2000/59/EC into legal system of Republic of Croatia. By aforesaid solutions the duty of port authorities was regulated, within a frame of doing monitoring over order performance in ports, particularly monitoring the coast and sea cleanness persistence against contamination from crafts (Art. 4. Regulation). Port authority monitors the facilities, devices and appliances that are in port and on other parts of maritime goods, and body which manages the port is engaged in cleaning the port from refuses which endanger navigation safety and contaminate sea. (Art. 5,21 Regulation). Chapter III, Article 60-67 of Regulation prescribes a procedure of reporting and reception of waste from crafts which is applied on *all ships, yachts and boats*, regardless the flag of convenience, which sail into the Croatian ports (except military and public ships) and is applied also on *all ports* where the aforesaid crafts sail into. By solutions in matter, the duty of nautical tourism ports was defined in making and applying the Plan for waste reception and handling, which is to be passed by body managing the port, acknowledging interests of concessioners (Art. 62 Regulation). Nautical tourism ports must have the Plan of locations of reception facilities with description of waste type from crafts which might be received and with instruction of utilization manner of reception facilities, list of offered operators and services, description of procedure for unloading, then procedure for reporting (see Appendix 1 Decree).

Even in year 1999 in Republic of Croatia the Regulation on classification and categorization ports of nautical tourism (Regulation on ports classification) was passed by which in disposition of Article 16 was prescribed that all nautical tourism ports (except the anchorages) must have equipment and facilities for trash, waste materials and water disposal, then the oil waste, too. By aforesaid regulation was regulated that the following ports of nautical tourism – marines, must have the insured equipment and facilities for disposal of trash waste materials. Number of marines, the most complex form of nautical tourism ports (Hlača; Nakić, 2010, p.182) in last ten years have increased for 18% (Master Plan and Tourism Development Stratey of the Republic of Croatia, 2011, p.102). Number of marinas in Croatia: 50 – 2004 year; 50 – 2005 year; 56 – 2006 year; 56 – 2007 year; 58 – 2008 year; 58 – 2009 year; 60 – 2010 year; 55 – 2011 year; 58 – 2012 year (Kovačić; Gračan; Jugović, 2015, p.126). In year 2013 Croatia was at penultimate position regarding number of marines comparing to following states: Italy – 429 marinas; France – 370 marinas; Spain – 360 marinas; Turska – 77 marinas; Croatia – 53 marinas and Grčka – 22 marinas (Institute for Tourism, 2015, p.13.). Pursuant to solutions from Art. 23, 26-28 Regulation on ports classification, the marine of third category (marine of lowest standard) had to have at least 1 container for solid waste of volume not smaller than $2m^3$ for 50 berths; marine of second category (marine of middle standard) had to have not less than 1 container for solid waste of volume not smaller than $2m^3$ for 40 berths, and marine of first category (marine of highest standard) at least 1 container for solid waste of volume not smaller than $2m^3$ for 25 berths.

By new Regulation on the classification and categorization ports of nautical tourism from year 2008 (Regulation on ports classification-2008) which came into force on the 23rd of June 2008, the nautical tourism ports were classified in following types: anchorage, disposal of crafts, dry marine, marine. Pursuant to disposition of Article 15 of Regulation on ports classification-2008, nautical tourism ports are committed to insure regular and legal removal of all sorts of waste from the port. By valid legal solutions an exact quoting of minimum number of containers for solid waste depending on number of berths was abandoned. Also, it was abandoned marines' classification into marines of first, second and third category. Existing solutions classify the marines into following categories: two anchors, three anchors, four anchors, five anchors (Art. 22 Regulation on ports classification-2008). Most of marines in year 2010 were not categorized according to new Regulation (Regulation on ports classification–2008) ie., there were 6 marines of I. category, 24 marines of II. category, 17 marines of III. category, and only 3 marines were categorized according to anchors number (Master Plan and Tourism Development Stratey of the Republic of Croatia, 2011, p.102). By terms for marines' categories (Appendix I. Regulation on ports classification-2008) quite specifically were prescribed the terms which marines of second, third, fourth and fifth anchor had to meet in terms of reception services; crafts' berths; common toilet facilities for tourists in marine; family bathrooms; catering contents for preparation and serving beverages, drinks and food; commercial and sport services and similar. Under the sub-chapter no. 10 of Appendix I. Regulation on ports classification– 2008, as regards terms for a marine's categorization, under the title „Quality of Setting, Equipment and Marine Maintenance“ was prescribed that regarding waste disposal it was required that a marine of second, third, fourth and fifth anchor obligatory had to have appropriate containers for separated collection of waste, regular waste elimination from marine (it is interesting that there were not mentioned numbers of adequate containers that is, frequency of waste elimination from marine depending on category of a marine!) as it had been standardized by modified and supplemented Regulation on classification and categorization ports of nautical tourism from 2000 and 2001. But, it is important to see that by Regulation on ports classification-2008 was

mentioned that all nautical tourism ports which already had solutions for nautical tourism ports according to Regulation on ports classification from 1999 – did not have obligation to conform with new regulation so they were holding over the categorization valid so far. Therefore are interesting data that in year 2015 there were 70 marines in Republic of Croatia: 13 dry marines; 6 marines of I. category; 19 marines of II. category; 17 marines of III. category and 15 marines categorized and marked by anchors (Croatian Bureau of Statistics, 2016, p.1).

Although the achieved level of technical- technological nautical tourism ports' equipment does not satisfy entirely (Kovačić, 2003, p.144) it is said for Croatia to be country with the best-quality marines in Mediterranean, but also in Europe (Luković, 2012, p.283). Final report in research implemented on system of port's reception facilities in period from the 2nd of February, 2009 till the 2nd of November, 2009 (Port Reception Facility Study, 2009, p.9, 12) showed that marines in Croatia were equipped with containers of limited volume for liquid oiled waste, as well as with containers for trash, but information on collected quantities in marines were so rare, so any reliable data were impossible to deduce therefor.

Systematic implementation of Directive solution 2000/59/EC means also the duty of master of the yacht and boat skipper to hand over overall ship's waste into the port reception facilities prior to sailing out from the port, which solutions are implemented also into Croatian legal system. Although the duty of port authority is to insure reception of waste emerged when cleaning and regularly utilize the maritime objects (Art.64 Regulation), the research demonstrated that ports that have introduced environmentally friendly policies and have implemented regulations increasing safety and environmental protection, seem to be ones that are finally prefered by the majority of boaters (Stelios Tselentis, 2008, p.48). According to the Report from the Commission to the European Parliament and the Council from 2016, the data indicate that in 2013 vessels are delivering more than double the amount of garbage delivered in 2004 (Report from the Commission to the European Parliament and the Council -Evaluation of Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues, 2016, p.6). Growing percentage of the boating public is willing to pay a higher slip cost for a better and cleaner facility so many marinas across the US are voluntary making environmental improvements to their facilities (Ross, 1999, p.72). Therefore, the measures for achievement of effective system for protection of maritime environment at national and international levels are in insuring the clear and competitive quality standards of nautical tourism ports' operation (Padovan, 2013, p.3), the carrying out of systematic monitoring of contaminators' impact in mentioned ports, then in insurance of common ecologic norms for reception facilities for liquid and solid waste from recreational vessels in all nautical ports EU member States.

4. CONCLUSION

Croatia is one of most desirable yachting destination in Mediterranean and Croatian Adriatic part is the cleanest marine area in Europe. Trans-border consequences of sea contamination with waste from ships may have impact on unexploitability of Croatian nautical tourism market potentials, since the good state of sea waters is the prerequisite of its development. Hence, development of consciousness on necessity of maritime environment protection and efficient system of maritime environment protection in marinas are the strategic goals of Croatian nautical tourism development.

In the study the legal effects of waste disposal from recreational vessels were analyzed according to Directive 2000/59/EC which aligns EU law with the international obligations provided in the MARPOL Convention improving the accessibility and utilization of port facilities for reception of ship's waste. Since EU Member States were committed to

implement the solutions of Directive 2000/59/EC into the national legislations until the 28th of December of year 2002, the authors indicated relevant Croatian sub-statutory regulations which had implemented solutions of Directive 2000/59/EC into national legal system. Analyzing the accelerated development of European and Croatian nautical tourism, the authors indicated the negative impacts of such development, the measures of maritime environment protection from ships' waste within marinas area, since marinas are most advanced kind of nautical tourism ports.

Systematic implementation of solutions in Directive 2000/59/EC and creation of European legal normative system resulted in detecting defectiveness and imperfections of European and Croatian solutions, in need of creation of systematic and entire law legislative as regards prevention efficient measures for emergence of maritime waste, then in quality measures for achievement of efficient waste managing. Analyzing the modalities of waste disposal from ships in Croatian legal system, the authors conclude that what is needed is insuring the quality legal solutions within Croatian sub-statutory regulations and in implemental regulations of nautical tourism ports as regards technical and technological equipment of marines, pursuant to solutions of Directive 2000/59/EC, but also actual implementation of its solutions at all levels.

LITERATURE:

1. Carpenter, A.; Macgill, S. M. (2003). The EU directive on port reception facilities for ship-generated waste and cargo residues: current availability of facilities in the North Sea, Marine Pollution Bulletin, no.46, p.21.
2. Case C-523/06: Judgment of the Court (Sixth Chamber) of 4 October 2007. Commission of the European Communities v Republic of Finland. Failure of a Member State to fulfil obligations – Directive 2000/59/EC. Retrived 1.2.2017 from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62006CJ0523.
3. Case C-81/07: Judgment of the Court (Third Chamber) of 13 March 2008. Commission of the European Communities v Hellenic Republic. Failure of a Member State to fulfil obligations – Environment – Directive 2000/59/EC. Retrived 1.2.2017 from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62007CJ0081.
4. Case C-106/07: Judgment of the Court (Fifth Chamber) of 6 December 2007. Commission of the European Communities v French Republic. Failure of a Member State to fulfil obligations – Directive 2000/59/EC. Retrived 1.2.2017 from http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A62007CJ0106.
5. Case C-368/07: Judgment of the Court (Seventh Chamber) of 25 September 2008. Commission of the European Communities v Italian Republic. Failure of a Member State to fulfil obligations – Directive 2000/59/EC. Retrived 1.2.2017 from http://europa.eu/rapid/press-release_IP-09-772_en.htm?locale=en.
6. Case C-480/07: Judgment of the Court (Second Chamber) of 11 December 2008. Commission of the European Communities v Kingdom of Spain. Failure of a Member State to fulfil obligations – Directive 2000/59/EC. Retrived 1.2.2017 from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62007CJ0480.
7. Croatian Bureau of Statistics, First Release (2016). Nautical Tourism: Capacity and Turnover of Ports 2015, no. 4.3.4. Retrived 20.3.2017. from www.dzs.hr/Hrv_Eng/publication/2015/04-03-04_01_2015.htm, p.1.
8. Croatian Nautical Tourism Development Strategy 2009-2019 (2009). Retrived 3.2.2017 from www.mppi.hr/UserDocsImages/Strategija razvoja nautičkog turizma HR 1.pdf, p.8, 22.

9. Davenport, J.; Davenport, J. L. (2006). The impact of tourism and personal leisure transport on coastal environments: A review, Estaurine Coastal and Shelf Science, no.67/2006., p.282-283.
10. Decree on condition to be met from the port (2004). Narodne novine, no. 110.
11. Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues. (2000). Official Journal of the European Communities, L 332, p. 81-90.
12. ESPO views on the revision of Directive 2000/59/EC on Port Reception Facilities for ship-generated waste and cargo residues (2016). Retrived 23.3.2017. from https://www.espo.be/media/espoviews/ESPO position papers on Port Reception Facilities_May 2016.pdf, p.1.
13. Güler, N.; Sağ, O. K. (2014). The Impact of European Union's Port Policies On Maritime Transport. Retrived 20.3.2017. from iamu-edu.org/wp-content/uploads/2014/07/guler.pdf, p.2, 6.
14. Guidelines for the interpretation of Directive 2000/59/EC on port reception facilities for ship generated waste and cargo residues (2016). Official Journal of the European Union, C 115, p.6, 8.
15. Hlača, V.; Nakić, J. (2010). The Legal Status of Marinas in the Republic of Croatia, Godišnjak Akademije pravnih znanosti Hrvatske, vol.1, no.1, p.182.
16. Hoenders, R. (2012). The EU experience with 10 years of implementation of the Directive on Port Reception Facilities. Retrived 20.1.2017. from http://www.green-marine.org/wp-content/uploads/2015/02/Roel-Hoenders.pdf, p.16.
17. Horizontal Assessment Report – Port Reception Facilities, Directive 2000/59/EC (2010). Retrived 10.3.2017. from http://ec.europa.eu/transport/sites/transport/files/modes/maritime/consultations/doc/prf/emsa-report.pdf, p.41.
18. Institute for Tourism (2015). Study on Nautical Tourism Development, p.12, 13, 21.
19. Kizielewicz, J.; Luković, T. (2013) The Phenomenon of the Marina Development to Support the European Model of Economic Development, International Journal on Marine Navigation and Safety of Sea Transportation, vol.7, no.3, p.463.
20. Kovačić, M. (2003). Development of Marinas Designed for Nautical Tourism Sustainability, Pomorski zbornik, vol.41, no.1, p.144.
21. Kovačić, M.; Gračan, D.; Jugović, A. (2015). The scenario method of nautical tourism development – a case study of Croatia, Pomorstvo, no.29, p.126.
22. Luković, T. (2012). Nautical Tourism in Croatia – Mega Yachts, Pro and Contra, When and How?, Naše more, vol.59., no.5-6, p.280, 283.
23. Luković, T.; Bilić, M. (2007). The Ports of Nautical Tourism in Croatia and Strategy of Local Development, Naše more, vol.54., no.3-4, p.116, 122.
24. MARPOL 73/78. (1973). International Convention for the Prevention of Pollution from Ships. Retrived 10.2.2017 from http://www.mar.ist.utl.pt/mventura/Projecto-Navios-I/IMO-Conventions%20%28copies%29/MARPOL.pdf
25. Master Plan and Tourism Development Strategy of the Republic of Croatia (2011). Retrived 21.3.2017. from www.iztzg.hr/UserFiles/Pdf/Izvjestaj-03-Strategija-razvoja-turizma-RH.pdf, p.102).
26. Padovan, A. V. (2013). Marina Operator's Liability Arising from Berthing Contracts and Insurance, Poredbeno pomorsko pravo, vol.52, no.163, p.3.
27. Port Reception Facility Study, PHARE Programme (2009). Retrived 1.3.2017. from http://www.mppi.hr/UserDocsImages/R20090322.pdf p.9,12.
28. Regulation on the classification and categorization ports of nautical tourism (1999). Narodne novine, no.142.

29. Regulation on the classification and categorization ports of nautical tourism (2000-2001). Narodne novine, no. 47/2000, 121/2000, 45/2001, 108/2001.
30. Regulation on the classification and categorization ports of nautical tourism (2008). Narodne novine, no.72.
31. Regulation on the conditions and method of maintaining order in ports and on other parts of internal waters and territorial sea of the Republic of Croatia (2005-2017). Narodne novine, no. 90/2005, 10/2008, 155/2008, 127/2010, 80/2012, 56/2013, 7/2017.
32. Report from the Commission to the European Parliament and the Council, Evaluation of Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues (2016). COM(2016) 168 final. Retrived 29.3.2017. from http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A52016DC0168, p.5, 6, 8.
33. Ross, N. W. (1999). How the Marina Industry profits from Clean Waters, ICOMIA 3d International Marina Conference. Retreived 1.6.2017. from www.icomia.com/library/Document.ashx?DocumentDataId=2035, p.72.
34. Stelios Tselentis, V. (2008). Marina Environmental Review System: A methodology to assess environmental management in recreational ports, European Research Studios, vol.11, no.1-2, 2008, p. 48.
35. Strategy for Sustainable Development of the Republic of Croatia (2009). Narodne novine, no.30.
36. Strategy for Maritime Development and Integrated Maritime Policy of the Republic of Croatia 2014-2020 (2014). Narodne novine, no.93, p.5,19.
37. Study on Nautical Tourism Development (2015), Institut za turizam, p.21.
38. Technical Recommendations on the Implementation of Directive 2000/59/EC on Port Reception Facilities (2016). EMSA. p.6.
39. Tourism Development Strategy for the Republic of Croatia 2020 (2013). Narodne novine no.55., p.38.

THE EFFECTS OF REGULATION (EU) No 524/2013

Neza Pogorelcnik Vogrinc
Faculty of Law, University of Ljubljana, Slovenia
neza.pogorelcnik@pf.uni-lj.si

ABSTRACT

The number of internet users is increasing significantly every year. Accordingly, every year the percentage of online shopping is increasing, however, the increase in cross-border online shopping is notably lower. As the main reason, consumers name the fear of disputes arising in relations with traders from other countries and problems related to resolving such disputes. As one of the solutions to encourage people to engage in cross-border online shopping, and consequently to indirectly accelerate economic growth, the European Union adopted Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes, by which an online dispute resolution platform was established. It connects various national alternative dispute resolution entities, which the consumer can choose from among when initiating an online dispute resolution procedure against the trader. These online procedures are supposed to be easy for the parties to participate in, quick, and cheap. In addition, the platform even provides for the electronic translation of the documents exchanged between the parties in the procedure. But will the new online dispute resolution system really work as envisaged? Will its benefits result in a surge in online cross-border shopping that will help boost the economy of the European Union? The paper presents the major features of the new online dispute resolution system and points out the parts of the Regulation that have the potential to go wrong when (massively) used in practice: the trader's right to a court, the expenses of the official translations, and the possibility of cross-border recognition and enforcement of final decisions, to name just a few.

Keywords: *consumer, online dispute resolution, platform, Regulation (EU) No 524/2013*

1. INTRODUCTION

Resolving cross-border disputes is not easy, quick, or cheap. Firstly, the claimant has to determine the court competent for the individual case. If he or she is unfamiliar with the laws of the country of the procedure, he or she needs to find, hire, and pay a lawyer in a foreign country. However, the end of the court procedure does not also entail the end to the issue. The next vital step is the enforcement of the court decision, which can be far from smooth as this requires finding and determining the debtor's property, obtaining a protective measure if needed, and ensuring the enforcement of the foreign court decision, which are accompanied by the possibility of failure at any stage. If a claimant is an individual with limited resources (such as a typical consumer), anticipating the length of the procedure, its costs, and other difficulties can scare him or her to the point of giving up and not utilising the available formal methods of recovering his or her claim. For disputes in which the weaker party is a consumer, the European Union (EU) has simplified and facilitated the provisions regarding jurisdiction.[1]

[1] According to the 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 (Official Journal of the European Union, L 351/1, BU I BIS), a consumer may bring an action against the other party to a contract either in the court of the Member State in which that party is domiciled or, regardless of the domicile of the other party, in the courts of the place where the consumer is domiciled. An

Regardless of that, consumers are not inclined to initiate a court procedure for a dispute involving a (very) low value. In order to enable and provide an easier and more accessible method to attain justice and consequently to eliminate the fear of cross-border purchases and sales, the EU introduced a new option for resolving consumer disputes. After years of debate and preparatory documents, 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 (Directive on consumer ADR)[2] 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)[3] were adopted in 2013. Even though only the Regulation on consumer ODR explicitly addresses the online resolution of consumer disputes, it largely refers to the procedural rules of the Directive on consumer ADR. The former should therefore be read together with the latter.
The Regulation on consumer ODR established an online dispute resolution (ODR) platform,[4] which became operational in February 2016. It represents an online "meeting place" of national ADR entities from all of the EU Member States that resolve consumer disputes arising from online sales contracts. The procedures are generally conducted without physical contact among the parties and the ADR entities; they are intended to be cheap for consumers and at the same time relatively quick, especially compared to court procedures. Will the use of the Regulation on consumer ODR in practise really bring about all of the envisaged positive effects? This paper will present the main features of the relatively new ODR system, emphasise its benefits, and point out its weaknesses.

2. THE PROCEDURE

The possibility of a new online procedure for resolving complaints is in the majority of the Member States available only to consumers.[5] The trader can initiate the procedure through the ODR platform only when the Member State on the territory of which it is established provides for such an option. In such cases, such a procedure is possible only against consumers who are residents of the same Member State (Article 2/II Regulation on consumer ODR).[6] For now, only Belgium, Germany, Luxembourg, and Poland have provided such a benefit to "their" traders.[7] A complainant files a complaint by filling in an electronic form that is accessible on the ODR platform.[8] The form is available in all of the 23 official

action may be brought against a consumer by the other party to the contract only in the courts of the Member State in which the consumer is domiciled (Article 18/I, II).
[2] Official Journal of the European Union, L 165/63.
[3] Official Journal of the European Union, L 165/1.
[4] See: www.ec.europa.eu/consumers/odr/main/index.cfm?event=main.home.show&lng=EN (accessed 18 May 2017).
[5] The ODR platform can also be used when the consumer and the trader are from the same Member State.
[6] This is also seen from the form of the complaint itself when the complainant indicates that it is a trader (see: www.ec.europa.eu/consumers/odr/main/index.cfm?event=main.home.show&lng=EN (accessed 20 April 2017)).
[7] For more on this see Pogorelčnik Vogrinc, 2017, forthcoming.
[8] The form of the complaint is accessible at: www.ec.europa.eu/consumers/odr/main/index.cfm?consumer-question1=Y&consumer-question2=Y&consumer-question3=N&complaintType=1&event=main.complaints.new (accessed 18 April 2017). The filing of an electronic complaint form is further regulated by Article 1 of the Commission Implementing Regulation (EU) 2015/1051 of 1 July 2015 on the modalities for the exercise of the functions of the online dispute resolution platform, on the modalities of the electronic complaint form and on the modalities of the cooperation between

languages of the EU. In addition to personal information, the complainant has to provide information on the trader (name, address, country, website, and e-mail address) and describe the complaint. The ODR platform sends the complaint to the trader's e-mail address, informing it that the parties have to choose an ADR entity. The trader then has a 10-day period to declare whether it agrees to such manner of dispute resolution, whether it is obliged to use any specific ADR entity, and if not, whether it is prepared to use any of the ADR entities from the list of those that are competent to deal with the complaint. The ODR platform then transmits this information to the consumer, who can express his or her (dis)agreement with the ADR entity within 10 calendar days (Articles 8 and 9 Regulation on consumer ODR).

The ADR entities themselves determine the rules of the procedure they conduct (*inter alia*, regarding the (non)binding nature of the outcome of the procedures, the language in which the procedures are conducted, the fees, the sectors, and the traders of which countries the entity is competent for). This information is published on the website of the ODR platform, which helps parties when deciding which ADR to choose. If the parties agree on the ADR entity, the platform transmits the complaint to it. The ADR entity notifies the parties whether it agrees to conduct the procedure and notifies them of its procedural rules and the costs of the procedure (Article 9 Regulation on consumer ODR). The procedure can be conducted through the platform or in any other manner (i.e. video conference, phone), but the physical presence of the parties or their representatives must not be required, unless its procedural rules provide for that possibility and the parties agree (Article 10/b, d Regulation on consumer ODR). One of the main advantages of an ODR procedure is therefore the possibility that it ends without the parties ever meeting and therefore it saves them the expense of travelling to the other Member State. The procedure has to be finished in 90 days,[9] which is one of the biggest advantages compared to a court procedure.

3. SPECIFIC QUESTIONS RELATED TO THE REGULATION

3.1 Is it possible to file a complaint against traders established in all of the Member States?

Member States have a duty to ensure the existence of ADR entities that conduct ADR procedures against the traders established on their territory (Article 5/1 Directive on consumer ADR). It is deemed that a Member State has fulfilled this obligation even if the ADR entity rejects the procedure in the specific dispute (Article 9/VII Regulation on consumer ODR in relation to Article 5/IV Directive on consumer ADR) (Gascón Inchausti in Stürner, Gascón Inchausti and Caponi, 2015, p. 48).

At the time of writing this paper (April 2017), there is a list of 277 ADR entities from 25 Member States. Croatia, Romania, and Spain have not yet notified[10] the European Commission of any national dispute resolution bodies. The absence of ADR entities in a specific Member State could therefore entail that consumers might not be able to use the platform to file a complaint against traders from that country.

contact points provided for in Regulation (EU) No 524/2013 of the European Parliament and of the Council on online dispute resolution for consumer disputes (Official Journal of the European Union, L 171/1).

[9] For more on this, see Section 3.3.

[10] This obligation derives from Articles 20 and 24/2 of the Directive on consumer ADR.

Regardless of that, the statistics show that complaints have already been filed also against traders from Croatia (75 filed complaints), Romania (460 filed complaints), and Spain (2,559 filed complaints).[11]

Apparently, some ADR entities have decided to conduct procedures also against traders established in other Members States (i.e. Italian ADR Center srl and Czech Česká obchodní inspekce[12] have declared that they conduct procedures against traders from all of the EU Member States, including from Norway, Iceland, and Liechtenstein, which will join the ODR platform only in the course of the year 2017). Consequently, consumers already have an option to file a complaint against traders from all of the Member States. The Member States therefore cannot "protect" traders established in their territory from consumers' complaints by not notifying the European Commission of any national ADR entities.

3.2 Voluntariness

One of the most important principles in ADR is the principle of voluntariness. Neither the Regulation on consumer ODR nor the Directive on consumer ADR explicitly includes this in their texts. It can be found indirectly in Recital 45 of the latter, which states that "ADR procedures should not be designed to replace court procedures and should not deprive consumers or traders of their rights to seek redress before the courts." But there could be a difference between the voluntariness of traders and that of consumers. A consumer can never be forced into an ADR procedure. He or she can agree to an ADR only after the dispute arises. An agreement between a consumer and a trader to submit complaints to an ADR entity that was concluded before the dispute arose is not binding on the consumer (Article 10 Directive on consumer ADR). Consumers are therefore protected when traders include an ADR clause in a purchase contract and the consumer as the weaker party cannot oppose it. But while consumers can voluntarily agree to an alternative dispute resolution procedure after the dispute emerges (see also Galič, 2000, pp. 556-557 and Pogorelčnik Vogrinc, 2015, pp. 257-258), the situation might be different for traders. They can also give their consent before, for example in the individual purchase contract or through membership in a professional organisation. Furthermore, another option exists to limit their voluntariness. The Directive on consumer ADR (Article 9/II(a) and Recital 49) determines that national rules can require the mandatory participation of the trader in ADR procedures. The European Court of Justice (ECJ) has already ruled that national legislation that requires prior implementation of an out-of-court settlement procedure is in compliance with the principles of the equivalence and effectiveness or the principle of effective judicial protection (Article 6 European Convention on Human Rights). But in those situations the outcome of such a procedure must not be binding on the party forced into the procedure (the trader). In addition, an ADR procedure must not result in a substantial delay as regards potentially bringing a legal action, it must not suspend the period for the time-barring of claims, and must not give rise to costs – or it must give rise to very low costs – for the parties (Rosalba Alassini v. Telecom Italia SpA, Filomena Califano v. Wind SpAC-318/08, Lucia Anna Giorgia Iacono v. Telecom Italia SpA,

[11] Source: www.ec.europa.eu/consumers/odr/main/index.cfm?event=main.statistics.show (accessed 20 April 2017).
[12] Source: www.ec.europa.eu/consumers/odr/main/?event=main.adr.show (accessed 20 April 2017).

C-319/08 and Multiservice Srl v. Telecom Italia SpA, C-320/08 of 18 March 2010).[13] When it is obligatory for the trader to participate in the ADR procedure, it therefore has to have an option to voluntarily decide whether it will accept the decision of the ADR entity or whether it will conclude an agreement with the consumer or not (Galič, Wedam-Lukić, 2000, supplement p. III). Otherwise a breach of its right to a court exists.

3.2 The costs of the procedure

One of the reasons for introducing ODR procedures was the disproportional costs of the expenses for court procedures compared to the value of the consumer dispute. That was and still is the main reason that consumers often decide not to initiate a court procedure[14] and would rather bear the costs of the defect in the product. This entails the enrichment of traders, especially when the number of unsatisfied consumers with small claims is big. That was the reason why the EU required that ODR procedures have to be cheap for consumers. Neither the Regulation on consumer ODR nor the Directive on consumer ADR determine the exact fee that consumers need to pay in such a procedure. An ADR procedure should be free of charge or available at a nominal fee for consumers (Article 8/c Directive on consumer ADR). The Directive itself does not interpret the meaning or the amount of the "nominal fee". That is left to the national regulations of the Member States and individual ADR entities.[15] In my opinion, leaving the determination of the fee to be paid by the consumer in the individual ODR procedure up to the ADR entities is appropriate. As a consequence, they bear the burden of finding a balance between the consumer and the trader (which will bear the rest of the expenses for the procedure), and at the same time compete among themselves for parties who choose an ADR entity also based on the costs of the procedure. Random checking of ADR entities on the ODR platform has shown that the fees to be paid by consumers are relatively low (approx. EUR 10–20) and some of them are even free. From the point of view of financial accessibility, this uniform European regulation of ODR procedures has therefore definitely achieved its aim.[16] Nevertheless, many consumer disputes are of a lower value than the fee to be paid by the consumer, so the decision to initiate an ODR procedure is still not self-evident.

3.3 The minimum value of a dispute

The obstacle to accepting a consumer dispute of a small value into an ODR procedure can also be completely formal. The Directive on consumer ADR envisages that each individual Member State may permit ADR entities to introduce a procedural rule that allows them to refuse to deal with a given consumer dispute when the value of the claim falls below or above a pre-specified monetary threshold (Article 5/IV(d)). The Directive itself does not specify the height of the threshold, which is therefore left to the discretion of each of the Member States.

[13] The ECJ also stated that such a settlement procedure must not be accessible only by electronic means and interim measures should be possible in exceptional cases where the urgency of the situation so requires.

[14] According to Eurobarometer research, FLASH EB 358, p. 72, 25% of the people surveyed had complaints deriving from consumer relations. 72% of them have tried to resolve such complaints with the trader, 12% with the producer, 4% in an ADR procedure, 4% at some other institution, and only 2% at a court. 17% of them have not carried out any act with the intent of resolving the dispute.

[15] The Slovenian Out-of-Court Resolution of Consumer Disputes Act (Official Gazette of the Republic of Slovenia, No. 81/15) therefore determined that the ADR procedure (and consequently also the ODR procedure conducted through the ODR platform) must be free for consumers, except for the fee set by the ADR entity, which can be a maximum of EUR 20 .

[16] Recitals 4 and 5 and Article 1 of the Regulation on consumer ODR.

The Slovenian Out-of-Court Resolution of Consumer Disputes Act enabled Slovenian ADR entities to determine such a value to be a maximum of EUR 30. On one hand, such a rule serves the principle of economy (*de minimus non curat praetor*), but at the same time a consumer with a dispute of such a low value (which is quite common) only has one (ineffective) option left, i.e. (an expensive and long) court procedure. This problem also arises when a trader agrees in advance (and publishes this information in accordance with Article 14 of the Regulation on consumer ODR on its website) to the resolution of consumer disputes by a specific ADR entity that has decided not to deal with disputes lower than a specific value (Pogorelčnik Vogrinc, 2017, forthcoming). In such cases, consumers with a dispute involving a lower value who at the time of purchase read on the website that the trader agrees to the ODR procedure (but they did not check the rules regarding the procedure of the chosen ADR entity), and therefore relied on that possibility of resolving any disputes, remain without such an option. Due to the fact a statement published on a trader's website that it agrees to the ODR system of resolving disputes might be a competitive advantage in comparison to other traders, this could also entail a possibility for misleading consumers as regards disputes involving a low value.

3.4 The length of the procedures

One of the biggest problems regarding court procedures, especially when the dispute is cross-border, is their length. Because the value of a consumer dispute is usually quite low, consumers are deterred from initiating a long (and expensive) court procedure. The aim of the EU was to provide a possibility that would provide parties quick access to a fair solution.

The Regulation on consumer ODR (Article 10 Regulation on consumer ODR in relation to Article 8/(e) of the Directive on consumer ADR) therefore gives ADR entities a period of 90 calendar days – from the date when the ADR entity has received the complete complaint file – in which the ODR procedure has to be finished. In the event of a highly complex dispute, the ADR entity can, at its own discretion, extend this period, where by the maximum length is not limited. The power to decide what is a "highly complex dispute" is left to the ADR entity conducting the procedure. Neither the Regulation on consumer ODR nor the Directive on consumer ADR determines sanctions to be imposed on the ADR entity in event of a delay in the procedure. It is therefore possible that in reality ODR procedures would be much longer than the envisaged 90 days. This can be checked to some degree through the information published on the ODR platform regarding the average length of the individual procedures at the specific ADR entity. Provided that the ADR entities have provided the European Commission with accurate data, the existing ODR procedures are of considerably different lengths. For the purpose of writing this paper, I checked more than half (167 out of 277) of the ADR entities listed on the ODR platform.[17] The amount of time for dispute resolution varies from 14 days to 10 months. The predicted length for a bit more than a third (37,12% - 62 out of 167) of the entities checked is exactly 90 days, the maximum allowed in the Directive on consumer ADR, and for 13,77% of researched ADR entities (23 out of 167) of the entities the procedure exceeds that period. The length of the remainder (49,1% - 82 out

[17] I checked the rules of procedure of the 167 ADR entities on the list of the European Commission. Among these is at least one ADR entity from each of the Member States. When there are more than one ADR entity from a specific Member State on the list (this is the case in all of the Member States, except Cyprus and Ireland) and I did not include all of them, I included the first one(s), as (alphabetically) listed on the ODR platform. As mentioned above Croatia, Spain and Romania have not notified the European Commission of any ADR entities, so none of their ADR entities were examined.

of 167) is shorter than the maximum allowed 90 days. It seems to be evident that the fears regarding extremely lengthy procedures exceeding the admissible period have not come true. In my opinion, the length of the procedure is one of the important factors based on which parties choose an ADR entity and is therefore a feature that can be easily compared, thus resulting in positive competition.

3.5 The language of ODR procedures

Among other information, on the ODR platform ADR entities must also declare the language(s) in which they conduct ODR procedures, which is normally[18] the language of the Member State in which the ADR entity is established. As each Member State needs to ensure the existence of such entities in order to conduct procedures against traders established in its territory,[19] this normally means that the language of the ODR procedure is also the language of the trader. The consumer therefore has to participate in the procedure in a foreign language, which would normally cause high costs due to translations (the translation of evidence, the translation of the communication between the ADR entity and the other party, etc.). In order to eliminate such an obstacle and make the procedure attractive for consumers, the European Commission provided for the automatic translation of all written communication on the ODR platform itself. Each of the parties to the procedure can now participate in the procedure in his or her own language (when filing a complaint and sending other communication), which must be one of the 23 official languages of the EU. At the same time, the ODR platform provides each of the parties an automatic translation of the communication of the opposing party into the selected foreign language (Article 5/IV(e) Regulation on consumer ODR). Consequently, the parties do not need a translator, even when the procedure is in a foreign language. Even if the provided free translation option is a huge advantage for both parties, there are some doubts as to the quality of such automatic translations, especially translations among "small" languages (Pogorelčnik Vogrinc, 2017, forthcoming).

3.6 The (non-)binding effect of a final decision

One of the most important factors for parties in choosing an ADR entity is the effect of the conclusion of the ODR procedure. The ADR might propose or impose a solution or bring the parties together with the aim of facilitating an amicable solution (Article 2 Directive on consumer ADR). The vast majority of ADR entities[20] opted for the procedure with a non-binding result (such as mediation), while just a minority conclude the procedure with a binding decision,[21] and an even smaller share[22] conduct two types of procedures: one with a binding result and the other with a non-binding result.

[18] Some of the ADR entities conduct the procedure in two languages (where one is the one of the country of its origin and the other is usually English, i.e. Italian ADR Center srl and Slovenian Evropski center za reševanje sporov) and some even in three (i.e. Luxembourgish Commission de Surveillance du Secteur Financier-CSSF in English, French and German; Irish NetNeutrals EU Ltd in English, French and Spanish). I have not noticed any ADR entity that conduct the ODR procedure in more than three languages.

[19] See Section 3.1.

[20] Approx. 83% of the ADR entities checked (139 out of 167) only conduct the procedure with non-binding effect.

[21] Approx. 12% (20 out of 167) of the ADR entities checked.

[22] A bit less than 5 % (8 out of 167) of the ADR entities checked.

If the parties agree to an ODR procedure that concludes with a binding decision, the question of its cross-border recognition and enforcement might arise. Neither the Regulation on consumer ODR nor the Directive on consumer ADR envisages the effect of these binding decisions.[23]
The determination of such an effect is left to the national legislation of the Member States.[24] If they do not regulate it appropriately it might happen that a final decision of the ADR entity that one of the parties (normally the trader) does not voluntarily respect remains without the desired effect and the consumer is left without an option to enforce it (neither in another Member State nor in the Member State of its issuance).

3.7 The impartiality of ADR entities

Among the ADR entities conducting ODR procedures there are also those established by or related to professional organisations and business associations. Traders normally need to pay a fee to become a member thereof and at the same time they agree to resolve consumer disputes by means of their dispute resolution system. Considering the fact that the members of such ADR entities are indirectly paid by the one of the parties in the dispute,[25] the question of their impartiality arises.[26] The Regulation on consumer ODR does not determine anything regarding this except for the statement that one of its intents is to provide impartial out-of-court resolution (Article 1). On the other hand, the Directive on consumer ADR determines more specific rules. The burden of ensuring that the persons conducting ADR procedures are independent and impartial falls on the Member States. In their national regulation they must therefore regulate and require that these persons fulfil the following conditions: they are appointed for a term of sufficient duration to ensure the independence of their actions: they are not liable to be relieved of their duties without just cause; they are not subject to any instructions from either party or their representatives; they are remunerated in a manner that is not linked to the outcome of the procedure; and that without undue delay they disclose to the ADR entity any circumstances that may, or may be seen to, affect their independence and impartiality or give rise to a conflict of interest with either party to the dispute they are asked to resolve (Article 6 Directive on consumer ADR). The conditions are the same regardless to the (non)binding nature of the final decision of the ODR procedure. Each Member State has to check applications of its ADR entities for the ODR platform and therefore ensure that they fulfil these conditions.

3.8 Use of the Regulation on consumer ODR thus far

The ODR platform has been in use for more than a year. The EU has been publishing statistics on the number of complaints filed by the country of the consumer and by the country of the trader.[27] In total, 29,220 complaints have been filed, of which 64.24% are

[23] Consequently, neither the Directive on consumer ADR not the Regulation on consumer ODR determines the rules for the recognition and the enforcement of binding final decisions, issued by ADR entities in ODR (or ADR) procedures. See also Bogdan, 2016, p. 157.
[24] For example, the Slovenian Out-of-Court Resolution of Consumer Disputes Act (Article 22/III) determines that the decisions of Slovenian ADR entities have the effect of a binding arbitration award.
[25] One of these ADR entities is the Slovenian Insurance Association, an economic interest group, which states that neither the consumer nor the trader needs to pay the fee for the procedure.
[26] The same doubt might arise for consumer organisations conducting ODR (and ADR) procedures in that they could be inclined to decide in favour of consumers. See also Vallines García, 2015, pp.87-88.
[27] These statistics are accessible at: www.ec.europa.eu/consumers/odr/main/?event=main.statistics.show (accessed 19 April 2017).

national. The greatest number of complaints have been filed by consumers in Germany (7,681), followed by the United Kingdom (7,090) and Spain (3,199).[28] Similarly, the greatest number of complaints against traders have been filed against those from Germany (8,341), followed by the United Kingdom (7,970), and Spain (2,555).

Among all sectors, the largest portion of complaints are filed with regard to the clothing and footwear sector (11.35% of all filed complaints), followed by airlines (9.03%), and information and communication technology (ICT) (7.85%). Due to the different nature of the various sectors, the different popularity of the online purchase of products from a specific sector, the different population of the Member States, and the different degrees of online sales among the traders in different Member States, it is difficult to make any conclusions only on the basis of this information and numerous questions can be posed. For example, is the number of complaints made by consumers from France not proportional to the number of inhabitants due to the well-functioning French ADR system or because consumers are insufficiently informed of the new ODR platform? Furthermore, do the greatest number of complaints occur in the clothing and footwear sector because such traders are the most reluctant to resolve consumer disputes?[29]

4. CONCLUSION

The main reason for introducing the ODR platform and the possibility of online procedures for resolving consumer disputes was to encourage people to engage in cross-border online shopping[30] and consequently to indirectly accelerate the economic growth of the EU. The predicted influence on the EU economy was quite significant. The available ODR system for e-commerce transactions is expected to save European consumers EUR 20 billion, of which EUR 2.5 billion deriving from cross-border disputes (Impact Assessment, SEC (2011) 1408 final, pp. 83, 84). Some years will need to pass before it is known if these numbers are accurate. The main factor is whether consumers will make use of this new option and initiate ODR procedures. This also depends on their awareness of this new alternative possibility. The Regulation on consumer ODR entered into force in 2013 and into application at the beginning of 2016. Despite the long period between its adoption and the onset of its application, at the beginning of 2016 the awareness of citizens of the new online mechanism was still low. Consumers should be informed of it by a notice published on the trader's website (Article 14 Regulation on consumer ODR), so that they can confirm the possibility of using the ODR platform to resolve any potential dispute with the specific trader. But this information is normally written in fine print and therefore, in my opinion, cannot be the primary manner of ensuring consumers' awareness of such mechanism. The main obligation to raise awareness of the new option for resolving disputes and the manner of its use still lies with the Member States, which therefore should strive to raise the relevant awareness of their inhabitants.

[28] The numbers are interesting because they are not the Member States with the highest population (Germany – approx. 81 mil.; France – approx. 66.5 mil.; United Kingdom – approx. 65 mil.; Italy – approx. 61 mil.; Spain – approx. 46.5 mil.) – source: www.europa.eu/european-union/about-eu/countries_en (accessed 19 April 2017).

[29] On the other hand the reason might be in the fact that this sector sees the greatest number of online purchases. That clothes and sports goods predominate in online purchases can be seen at: www.ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics_for_individuals#Clothes_and_sports_goods_predominate_in_online_purchases (accessed 19 April 2017).

[30] The share of people buying online from the foreign traders is increasing every year, but consumers state that they are less inclined to make cross-border purchases. Source: www.ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics_for_individuals#Clothes_and_sports_goods_predominate_in_online_purchases (accessed 19 April 2017).

LITERATURE:

1. Bogdan, M. (2015). The new EU regulation on online resolution for consumer disputes. *Journal of Law and Technology*, 2015(1), pp. 155-164.
2. Commission Implementing Regulation (EU) 2015/1051 of 1 July 2015 on the modalities for the exercise of the functions of the online dispute resolution platform, on the modalities of the electronic complaint form and on the modalities of the cooperation between contact points provided for in Regulation (EU) No 524/2013 of the European Parliament and of the Council on online dispute resolution for consumer disputes. (2015). *Official Journal of the European Union*, L 171/1, pp. 1-4.
3. 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. (2011). *Official Journal of the European Union*, L 165/63, pp. 214-230.
4. Dispute resolution bodies. Retrieved 20. 04. 2017 from https://ec.europa.eu/consumers/odr/main/?event=main.adr.show.
5. *Eurobarometer*: *FLASH EB 358*. (2013). Retrieved 14. 04. 2017 from http://ec.europa.eu/public_opinion/flash/fl_358_en.pdf.
6. *E-commerce statistics for individuals.* (2016). Retrieved 19. 04. 2017 from http://ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics_for_individuals#Clothes_and_sports_goods_predominate_in_online_purchases.
7. Galič, A., Wedam-Lukić, D. (2000). Perspektive alternativnega reševanja civilnih sporov v Sloveniji. *Pravna praksa*, 2000 (29-30), supplement pp. I-VIII.
8. Galič, A. (2000). Procesni vidiki prava varstva potrošnikov. *Podjetje in delo*, 2000 (3-4), pp. 550-562.
9. Gascón Inchausti, F. (2015). Specific Problems of Cross-Border Consumer ADR: What solutions?. In M. Stürner, F. Gascón Inchausti, R. Caponi (ed.), *The Role of Consumer ADR in the Administration of Justice, New trends in Access to Justice under EU Directive 2013/11* (first edition) (pp. 31-57). Munich: Sellier European Law Publishers.
10. Impact Assessment, Accompanying the document, Proposal for a Directive of the European Parliament and of the Council on Alternative Dispute Resolution for consumer disputes (Directive on consumer ADR) and Proposal for a Regulation of the European Parliament and of the Council on Online Dispute Resolution for consumer disputes (Regulation on consumer ODR). (2011). SEC(2011) 1408 final.
11. Pogorelčnik Vogrinc, N. (2017). Spletno reševanje potrošniških sporov. In M. Damjan, A. Vlahek (ed.), *Varstvo potrosnikov pri spletnem poslovanju* (first edition) (forthcoming). Ljubljana: GV založba.
12. Pogorelčnik Vogrinc, N. (2015). Implementacija Direktive 2013/11 o alternativnem reševanju potrošniških sporov v slovenski pravni red. In M. Damjan, A. Vlahek (ed.), *Pravo in politika sodobnega varstva potrošnikov* (first edition) (pp. 251-282, 481, 493-494). Ljubljana: IUS Software, GV založba: Inštitut za primerjalno pravo pri Pravni fakulteti.
13. 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. (2012). *Official Journal of the European Union*, L 351/1, pp. 289-320.
14. 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. (2013). *Official Journal of the European Union*, L 165/1, pp. 202-213.
15. Reports and statistics. Retrieved 19. 04. 2017 from https://ec.europa.eu/consumers/odr/main/?event=main.statistics.show.

16. *The 28 member countries of the EU.* Retrieved 19. 04. 2017 from http://europa.eu/european-union/about-eu/countries_en.
17. The complaint of the ODR procedure. Retrieved 18. 04. 2017 from https://ec.europa.eu/consumers/odr/main/index.cfm?consumer-question1=Y&consumer-question2=Y&consumer-question3=N&complaintType=1&event=main.complaints.new.
18. The ODR platform. Retrieved 18. 04. 2017 from www.ec.europa.eu/consumers/odr/main/index.cfm?event=main.home.show&lng=EN.
19. The Out-of-Court Resolution of Consumer Disputes Act. (2015). *The Official Gazette of the Republic of Slovenia*, 81, pp. 8825-8831.
20. Vallines García, E. (2015). Impartiality and Independence of the Persons Entrusted with Consumer ADR. In M. Stürner, F. Gascón Inchausti, R. Caponi (ed.), *The Role of Consumer ADR in the Administration of Justice, New trends in Access to Justice under EU Directive 2013/11* (first edition) (pp. 79-102). Munich: Sellier European Law Publishers.

ENSURING TAX STABILITY THROUGH ADVANCE RULINGS IN (SLOVENE) PRACTICE

Polonca Kovac
University of Ljubljana, Faculty of Administration, Gosarjeva 5, SI-1000 Ljubljana, Slovenia
polonca.kovac@fu.uni-lj.si

Tatjana Jovanovic
University of Ljubljana, Faculty of Administration, Gosarjeva 5, SI-1000 Ljubljana, Slovenia
tatjana.jovanovic@fu.uni-lj.si

ABSTRACT

Advance ruling is a tax instrument designed to mitigate the growing need for clarity and predictability of tax law relations. Many legislations introduced this tool in order to ensure legal certainty and economic stability. In Slovenia, advance ruling was introduced in 2006 with the adoption of the Tax Procedure Act (TPA). As stipulated by Article 14 of TPA, the tax authority issues advance rulings in individual cases based on future facts. The analysis of case law reveals that one of the key issues concerning advance rulings is their unclear legal nature. Furthermore, high fees and excessive length of procedures cause problems in the implementation of the TPA. This paper addresses the main considerations for efficiency of tax advance rulings in Slovenia in terms of legal analysis of the TPA, the Rules on its implementation, respective administrative practice and case law. An empirical study was carried out among tax consultants and the tax authority to verify the hypotheses on the non-optimal regulation and differing views of the tax authority and taxpayers. Thus, several recommendations on de lege ferenda improvements were formed, for comparable countries as well.

Keywords: *advance ruling, legal certainty, Slovenia, tax proceduree*

1. INTRODUCTION

The main purpose of taxation is to collect revenues or, to put it more broadly, to finance the government and welfare state (Watson, 2016, Jovanović, Klun, 2017). However, this goal is multifaceted since taxes have economic, social and political functions. Speaking in terms of economy, the most important are the principles of neutrality and stability, yet in social, political and administrative terms equally crucial are the allocative, redistributive and developmental functions. The purpose of taxation is not raising money only for the sake of it, but rather the participation of authorities (state, municipality or the EU) in the profits and surpluses of private incomes and assets. Therefore, regulation must enable tax liability fulfilment in different ways, simplified enough to run effective tax policies and not unnecessarily burden neither taxpayers nor the tax administration. Tax law, with the overall harmonisation and rule of reason of tax authorities' activities, is in this sense of growing importance at the European level to ensure the rule of law, efficiency and good administration (Lang, 2010, Kovač, Bileišis, 2017). Namely, any administrative relation, especially an authoritative one, should be predictable in a democratic state and competitive economy, as it is guided by international and constitutional principles. Legal and economic stability are in a direct interest of businesses as well, even though certain rules impose administrative burden upon them as taxpayers. However, these are legitimate as long as they are predictable and non-discriminatory. Advance ruling is one of the tax instruments closely related to several of the fundamental principles of administrative affairs in general and tax procedures in particular, such as legality, legal certainty, transparency, equality, efficiency,

etc. (Romano, 2002, Kovač, 2012, Galleta et al., 2015, pp. 2, 17, etc.). Consequently, many countries have enacted such instrument for various reasons and in different forms. These legal arrangements differ by legal source as well as by content and legal nature of advance ruling (see for instance for US, the Netherlands, Germany, Czech Republic, Finland, France, Spain, Hungary or Croatia since 2015; more in Romano, 2002, Lang, 2010, van de Velde, 2015, Žunić Kovačević, 2016). Nevertheless, in the majority of respective countries, the reasons for the argumentation of this instrument originate from the need to inform the taxpayers, provide legal predictability and non-discrimination in tax matters, and raise the level of trust into law and public administration. Slovenia followed the trends in the field by adopting the Tax Procedure Act (TPA) in 2006 (more on the Act as a whole and regarding specific provisions in Jerovšek, Simič, Škof, 2008). Advance rulings have been since then issued – as stipulated by Article 14 of the TPA – in individual cases based on future and potential relevant facts. Therefore, the legal nature of this Act is a hybrid one. For this reason, as well as due to other issues, such as relatively high fees (EUR 4,770 on average) and excessive length of procedures (five months on average) the implementation of the TPA is problematic (see FARS annual reports, 2017). Moreover, the Slovene tax authority (Financial Administration of the Republic of Slovenia, FARS) seems reluctant in informing the taxpayers; hence, this instrument is rarely applied. This is evident from less than 10 cases of advance rulings claimed and even less issued annually despite nearly three million taxpayers in Slovenia. This paper explores the said inconsistencies in the ten years from the introduction of advance ruling in the TPA, in both legal regulation and practice. The main objective of the paper is to evaluate the instrument through the lenses of the tax authority and tax consultants. Two hypotheses are verified:

- *H1: The Slovene regulation of tax advance ruling does not fully comply with the principle of certainty due to the instrument's unclear legal nature and protection.*
- *H2: Tax consultants perceive legal provisions and practice as more limited than the Slovene tax authority.*

The research methodology is based on the legal analysis, administrative statistics, selected case-law research and in-depth interviews with experts, with some comparative insights. The purpose of this study is to determine the prevailing elements of this instrument and its legal nature to enable legal protection and thus enhance its use. The taxpayers should in fact be guaranteed all legal effects of advance ruling, especially judicial review, regardless if they understand it as an administrative regulation, an administrative decision, or a guarantee act (compare on legislative, interpretative and procedural rules and regulations and IRS rulings and their effects for US in Watson, 2016, pp. 13ff, 32ff). The main principle pursued by advance ruling is legal certainty and stability of investors in the Slovene and European markets. On these grounds, some necessary improvements are suggested to make this instrument a useful tool instead of being only a dead letter in the law (Kovač, 2016, p. 1574).

2. LEGAL REGULATION OF ADVANCE RULINGS

2.1. General on tax regulation and procedures in Slovenia

Tax sector regulation is detailed since it defines relations that usually impose burdens, among others to businesses as taxpayers. Regulation should therefore serve as a predictable and proportionate tool to guarantee public revenues and simultaneously prevent tax evasion on one hand and the abuse of power by the tax authority on the other. Hence, it is not surprising that the European Union and every Member State regulate tax affairs very carefully (more in Lang, 2010). Slovenia follows this path, based on its legal German-Austrian and post-socialist heritage, its independence since 1991, its full EU membership since 2004, and the economic crisis and other key milestones of political and administrative development (Kovač,

Bileišis, 2017, p. 302). Slovenia adopted many new legislative acts as a result of EU harmonisation, as goes for most of the tax related regulations (Jerovšek, Simič, Škof, 2008, p. 6). A historical insight is important, we believe, since it enables us to understand certain solutions and attitudes which are characteristic for present tax law and tax authorities despite potentially important changes. One of the key acts, aiming in particular to ensure the basic minimum standards for all taxpayers regardless of the tax to be collected, the status of the taxpayer or any other circumstance, is the Tax Procedure Act (TPA, in Slovene: Zakon o davčnem postopku). Prior to its adoption, the general Administrative Procedure Act (APA, in Slovene: Zakon o splošnem upravnem postopku) served this purpose, which is now applied (only) subsidiarily. Superior to the TPA are EU regulations (mostly related to customs) and directives with further national substantive laws on specific taxes (approx. 30 different acts). Legal certainty is of crucial importance in such regard due to the constitutional requirement of any tax being imposed only by law. Slovenia enacted its first TPA in 1996 (*ZDavP*), the next one in 2004 (*ZDavP-1*) and the currently valid version in 2006, in force since January 2007 (*ZDavP-2*, Official Gazette of Republic of Slovenia, No 117/06 and amendments). The latter regulates, among others, seven basic principles (legality, protection of public interest and taxpayers' rights, proportionality, privacy, etc.) and legal grounds for tax collection. As regards the basic principles of administrative and, especially, tax procedures, the public interest of tax collection is not absolute and unlimited. The proportionality in regulation requires, for instance, in a substantive sense the introduction of general tax reliefs and in the procedural aspect no procedures when the cost of their administering would exceed the tax levied. Furthermore, it is important not to regulate a principle or a right just on paper but to also regulate its effective protection (Kovač, 2012, p. 401). The 2006 TPA was the first law in Slovenia to provide grounds for internationally already recognised mixed acts as a base for tax collection. Before 2007, tax procedures were conducted in Slovenia relatively legalistically. That means that not only the law was to be followed but also other legal grounds too, i.e. within lawfully defined goals and principles of administrative matters, such as guidelines, agreements or guarantee acts (as usual in Central, Eastern and Southern Europe, see Koprić, Kovač, Đulabić, Đinić, 2016). In Slovenia, tax procedures are additionally regulated in much detail given their status of special administrative procedures and therefore the need to strike a balance between the efficient collection of public duties in the public interest and the procedural protection of taxpayers' rights. Despite an effort for more general regulation and red tape reduction (see more on selected measures in Kovač, 2012), the TPA incorporates over 400 articles, many related to substantive issues or specific taxes. Tax authority in Slovenia is mainly centrally organised by the Financial Administration of the Republic of Slovenia (FARS) with 15 regional, one special and one coordination general branch and 3,660 employees, incorporating tax and customs procedures since 2014 (FARS, 2017). The FARS collected in 2006 altogether EUR 14,603,678,755 revenues, including social contributions, from approx. 2.83 million active taxpayers, including around 260,000 business taxpayers (160,000 legal entities and 100,000 individual entrepreneurs). The FARS is a decision maker on the first instance. As a rule, acts on tax collection are enforceable immediately upon delivery; yet any individual act can be appealed before the Ministry of Finance. Moreover, after completeness in administrative procedure, taxpayers can dispute decisions before the Administrative Court and further before the Supreme and Constitutional Courts. Annually, there are about 2.5 million tax related administrative acts issued and 20,000 appeals lodged. Given the huge numbers of taxpayers, fair and efficient legislation and administration are essential, and an enormous demand for rulings is not surprising (Watson, 2016, pp. 2, 21).

2.2. Customs and tax advance rulings in European and Slovene legislation

In order to develop more efficient, fair and partnership oriented procedures, the Slovene legislature opted for two new instruments in 2006. First, in Art. 13 of the TPA, the so called mandatory instructions for a unified interpretation of legislation were introduced but later annulled by the TPA amendment of 2015 (*ZDavP-2I*) due to their unclear application (and replaced by the introduction of advance pricing arrangements). Second, the advance rulings, regulated by Art. 14 of the TPA based on the Dutch and Austrian model (Kovač, 2016). At the EU level, tax advance ruling is not unified, thus allowing Member States to adopt different solutions even though the EU and experts (see Romano, 2002) try to implement convergent solutions, such as adoption and implementation of Directive 2015/2376 (OJ L 331/1, 18 December 2015) on exchange of tax data. On the contrary, unification is present regarding customs rulings, especially on tariff classification and origins as stipulated by Art. 33–37 of the Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013, laying down the Union Customs Code. This Regulation regulates 'binding' information that is (a) binding tariff information (BTI decisions) and (b) decisions relating to binding origin information (BOI decisions). As regards customs, the EU emphasises the binding, i.e. mandatory (especially for tax authority) rather than advance character (as in Slovenia Art. 14 of the TPA). The binding character is supported through unified procedure provisions for issuing the respective acts based on the EU form application as individual acts (decisions). Moreover, customs information have effect throughout the EU territory, in principle for a three years period. Regarding Slovene tax advance rulings, the TPA and the related Rules on the implementation thereof specify the requirements, the procedural elements and the effects of these acts. As put forward by the proposal of the TPA, the aim is to increase legal certainty and support taxpayers at fulfilling their tax liabilities. According to the TPA, advance ruling refers to information issued by the principal (central) financial office of tax authority (FARS) at the request of a taxpayer on the tax treatment of planned transactions or business events with a 6-month reply timescale (compared to 30 days in Austria, for instance). It concerns future taxation and thus facilitates the taxpayer's decision whether the expected tax, as part of expenses compared to the expected profit, is an acceptable burden for a business transaction to be undertaken. Information is binding for the authority in relation to a concrete taxpayer. The provisions on advance ruling are highly detailed, but most importantly full of excluding clauses, e.g. the tax authority can decide within 15 days not to issue the advance ruling at all. Additionally, the ruling is not binding when even the slightest element fails to comply with the circumstances given in the application (similarly but rarely so exclusive in some other countries also for otherwise binding acts, cf. van de Velde, 2015, Watson, 2016, pp. 19, 20, 23– 25, 39). Costs are calculated based on the Rules separately from the proceeding for the issuing of advance ruling, amounting to EUR 50 for an hour of work but no less than EUR 500, with prior payment if costs exceed EUR 2,000. The average costs are indeed high, i.e. EUR 4,770 per ruling issued. A ruling can also be published online (FARS website) with disclosure of individual but anonymised data (but it is not published obligatory as revenue rulings in US in the official Bulletin, for taxpayers to easily find and rely on it, neither accessed as a public information as for individual letter rulings, see Watson, 2016, pp. 19, 21). In the case of online publication, Slovene advance ruling takes precedent effect (see the same on 'public ruling' in Romano, 2002, pp. 61, 82, Žunić Kovačević, 2016, p. 271, but not so in US letter rulings). However, judicial review is allowed only regarding the compliance of inferior acts versus superior ones before the Constitutional Court. Such legal regulation means that advance rulings serve as a complementary legal source since they are binding for the tax authority when the transaction in question is finally made (Žunić Kovačević, 2016, p. 281). However, issuing advance rulings does not represent a decision on the already existing

taxpayer's liability despite its individuality. Consequently, it is not regarded as 'classical' tax administrative proceeding and the act is not taken as a decision with a defined legal protection before the Ministry of Finance and Administrative Court (Jerovšek, Simič, Škof, 2008, p. 24, Kovač, 2012, p. 400). The above elements of tax advance rulings regulation lead to a rather low use of this instrument in Slovenia (see annual reports, FARS, 2017, Kovač, 2012, p. 403, Kovač, 2016, p. 1565). Practice in fact shows that most applicants are not familiar with the goal of advance ruling and its legal characteristics.

3. SLOVENIAN ADVANCE RULING PRACTICE AND CASE-LAW – DILEMMAS

Due to detailed yet unclear regulation, there are many dilemmas in Slovenian administrative practice and case law. So far, these problems have been neither detected nor resolved. The core dilemma seems to concern the legal nature of tax advance ruling and (the lack of) their further effects. Namely, tax advance ruling – as pursued by Art. 14 of the TPA and its interpretation – is a hybrid since it indeed addresses specific taxpayers, yet it refers to future and potential relevant facts. This is of major importance since the Slovene legal system does not acknowledge such hybrid acts. In fact, theory and practice only know: (1) abstract and general acts addressing future facts regarding undefined (non-individualised) parties; and (2) concrete and individual (administrative) acts, referring to specific taxpayers and already existing relevant facts, i.e. finalised tax transactions for tax collection. Customs related information such as BTI fits in the second category; hence, the statistics on their application and judicial review are expectedly high and stable, with almost 200 acts annually issued in Slovenia (see Table 1). On the other hand, tax advance rulings are very rare, which refers to both applications for and, more so, the issuing of rulings based on Art. 14. The latter accounts for only 1.2 per year despite the legal grounds for this instrument being available for already ten years. The figure is slightly but not significantly higher if we take into account some of the acts issued based on Art. 13 (mandatory instructions as general acts; see Jerovšek, Simič, Škof, 2008, p. 44). Distinction is to be preserved between the two, however, since 'advance' does not necessarily mean 'binding' (as e.g. in the customs area).

Table 1: Statistical data on advance ruling (FARS, 2017)

Year	*No of tax rulings (applications)*	*No of BTI*
2007	2 (14)	N/A
2008	3 (7)	N/A
2009	0 (12)	N/A
2010	2 (8)	317
Year	*No of tax rulings (applications)*	*No of BTI*
2011	0 (7)	296
2012	0 (4)	215
2013	1 (7)	197
2014	2 (9)	234
2015	1 (5)	176
2016	1 (6)	206
Sum	12 (79)	1,331 (year 2010-)
Annual average	1.2 (8)	190

The legal nature of an act, as revealed also for tax advance rulings, is important because of two groups of legal effects (more in Kovač, 2016). The first one is about when do external and individual legal consequences for taxpayers arise and, when enforceable, to whom they refer. The second one concerns the type of legal protection, which is guaranteed by an appeal

and court action only in case of individual administrative acts. The tax authority published on its official website the *Instructions on tax advance ruling* (No 007-58/2007-01131-03, 4 May 2007), stating no external effects whatsoever, meaning that they are limited to an individual applicant only. In later editions (April 2015, 4 pp., FARS, 2017), no such statement is provided, leaving the interpretation open to a case-by-case basis, which does not contribute to legal certainty and tax stability. Moreover, the TPA itself uses – when referring to the issuing of information – the wording 'letter' or 'certificate', thereby dismissing any legal effects even for an individual taxpayer. The TPA does not provide for an appeal, which can be filed only against a decision on tax liability after the transaction is concluded. The costs of issuing advance rulings are also not mentioned despite being otherwise obligatory when issuing decisions. Therefore, any appeals against advance rulings are formally dismissed. It seems that the tax authority in Slovenia cannot decide whether to act authoritatively and take over the effects and the disputability of its acts accordingly (cf. Žunić Kovačević, 2016, p. 275, on judicial protection also van de Velde, 2015, pp. 7, 24, 46). Alternatively, the tax authority could act only informatively, but in this case, no legal implications can be expected. To our belief, the legal nature of advance ruling is provided by the TPA. However, advance ruling can be regarded either as a (more) general or an individual act, but a decision must be made to allow taxpayers the protection of their rights. The tax authority cannot act differently in same or very similar cases, i.e. once issuing only individual acts and then again publicising them as general instructions. Therefore, the TPA should define the legal nature of tax advance ruling as an individual or general act or – ideally – allow both, but clearly divided options, as is the case in the Netherlands (van de Velde, 2015, pp. 33ff) and US with so called (general) 'revenue rulings' and lower (individual) '(private) letter rulings' (Watson, 2016, pp. 18–25). A legal definition is required to our opinion particularly because case law in Slovenia does not clarify the above dilemmas, but even deepens open questions. In accordance with the verdict of the Supreme Court, No I X Ips 76/2014 of 23 April 2015, the court considered an act titled 'explanation', published in 2012 on the FARS website, as a general act on self-declaration and calculation of interests. The main question then was whether the act was binding pursuant to the TPA since the tax authority had rewritten some parts after its publication without notifying what and when. The court decided that informing taxpayers is such an important task of the tax authority that despite a perhaps non-binding nature of the act, FARS should not redefine its acts. This verdict is important since it conveys a principle of legal certainty and legitimate expectations as a key for developing trust, equality and legality in tax matters and public administration in general. Based on this case, we can further assume primary general implications. Contrary to the above reasoning, the 2015 TPA amendment explicitly redefined general instructions or explanations and information as having a binding or obligatory effect. Several verdicts in such regard are available in the publicly accessible database of the Supreme Court, taking particularly customs and related information as individual administrative decisions (e.g. cases Nos X Ips 102/2005, 17 December 2007, X Ips 494/2004, 10 September 2009, U 233/2008, 3 February 2009). Nevertheless, as emphasised by the Constitutional Court, case U-I-6/13-12, Up-24/13-16, 11 February 2016, taxpayers must be ensured the possibility to effectively assert their rights to judicial protection of rights and legal interests. Therefore, we call for a clear definition of the legal nature of tax advance rulings by the TPA as an individual decision, guarantee act or general act, or a combination thereof. Only clear law leads to non-disputable practice.

4 EMPIRICAL STUDY ON EFFICIENCY OF SLOVENE ADVANCE RULINGS

4.1. Methodological framework

The particularity of the research problem led us to choose the appropriate methodology. The empirical part of our research is based on the previous theoretical, comparative, normative

and statistical analyses. It is further conducted through in-depth interviews with experts in the field. Since our preliminary research of statistical data on advanced rulings revealed very low figures of relevant cases, the methodology could not include any quantitative research. The structured interviews were therefore carefully designed, targeting the priority areas, i.e. comparatively open dilemmas that seem to be problematic in Slovene practice when applying for and issuing tax advance rulings. The comprehensibility and clarity of the questions were tested on a few pilot interviews (two scholars and two tax consultants). Following this step, we prepared a final set of questions to obtain not only basic answers but also the respondents' background experience and reasoning. The expertise and experience of the interviewees were a guarantee of credibility and validity of data collection. The majority of interviews, i.e. with tax consultants, was conducted in face-to-face meetings, except for the Slovene tax authority which provided its official stance in a written reply to our survey. In order to analyse the tax instrument on the basis of six relevant factors (legal nature, timing, legal wording, costs, rare use in practice and BTI decisions), ten structured questions were applied:

1. Specification of the legal nature of tax advance ruling (Article 14 of the TPA) as pursued by the TPA, which is issued to (each) taxpayer at request, but it can be made publicly available for the same types of cases after anonymization;
2. Specification of the legal nature of tax advance ruling for future application (in relation to the different rules in the EU), aiming at higher certainty, transparency and tax stability (*de lege ferenda*);
3. Assessment of clarity of Article 14 of the TPA regarding the timing in which the tax authority should issue the advance ruling (decide in 15 days whether the advance ruling will be issued, and issue it in six months);
4. Opinion on reasonable time limit for issuing the advance ruling (the average time since 2007 has been five months, FARS, 2017);
5. Assessment of clarity of Article 14 of the TPA regarding the definition of content; what are the obligations of the taxpayers and the tax authority (e.g. which documents should be included; how the transaction should be elaborated);
6. Comment the fact that the majority of taxpayers that have applied for advance ruling have not been familiar with the purpose of this instrument (FARS, 2017);
7. Comment the average cost of advance ruling (around EUR 4,770 per taxpayer);
8. Opinion on the main reasons for the very rare applications and even rarer issuance of tax advance rulings in practice despite its enactment already in 2006;
9. Opinion on the risk of business policy disclosure as one of the key reasons for the rare use of tax rulings despite anonymization, and consequently the reduction of competitive advantages;
10. Comparison with significantly higher usage of binding tariff information (BTI decisions) vs. tax advance ruling.

Since we anticipated basic differences in experience and answers by the tax authority and the taxpayers represented by tax consultants, we opted to do the research in parallel. Based on preliminary telephone and/or e-mail communication, fifteen tax consultants were selected, taking into account that there are approx. 50 tax consultants in Slovenia (which is not an officially licenced status). In addition to references, the criterion for the selection of interviewees was at least one application prepared or at least one meeting held with the tax authority (FARS). The tax authority received the interview questions by e-mail in order to

ensure a unified and officially confirmed answer. We received in March and April 2017 all the replies that we asked for, which we consider a significant base to make concrete and representative conclusions on the chosen research problem of low usage of tax advance ruling in Slovenia.

4.2. Results and discussion

When analysing the results of the interviews, differences in tax consultants' views compared to the tax authority's view are not surprising and confirm both of our hypotheses. The main results of in-depth interviews are presented in Table 2, separately for the tax authority (FARS) and the tax consultants. The legal nature of tax advance rulings is apparently unclear to all stakeholders, which leads to unpredictability of this instrument, contrary to the desired effects of the law and comparable European practice (van Velde, 2015). Moreover, tax consultants see the legal provisions as significantly more limited compared to the tax authority's stance. Although expected, this calls for a more open attitude and proactivity of the respective body.

Table 2: Summary of in-depth interviews results (own analysis)

Tax advance rulings'	*Tax authority (official stance)*	*Tax consultants (N=15)*
1. Legal nature	Clear – individual administrative act	Not clear, most opt for individual administrative act, others for general administrative act, and some see it as a unique act
3. Legal wording	Undoubtable	Unclear for taxpayers and tax experts
3. Timing	Up to 6 months is appropriate	Up to 2 months is appropriate, taking into account rapidly changing market conditions
4. Costs	Reasonable, especially due to lack of resources	Too expensive on average
5. Low usage is due to	Lack of information among taxpayers	Expensive instrument and excessive deadlines (not proportionate)
6. BTI decisions are more often used due to	Unified EU legislation and effects	Technical nature/simplicity, better organisation of customs service

The answer of the tax authority (FARS Director General) as far as the legal nature of tax advance ruling is concerned, is completely unambiguous. Advance ruling is an individual administrative act and should remain such in the future. On the contrary, the analysed answers of tax consultants – as well as previously elaborated case law in Slovenia and comparative practices in the EU – reveal that the instrument is sometimes seen as an individual and sometimes as a general act. In addition, some respondents attribute it a *sui generis* explanation (e.g. considering the tax ruling to be a certificate only), while others still do not even consider this issue although they should do so given their field expertise but mainly economic and not legal backgrounds. In sum, the legal nature of tax advance ruling is – according to tax consultants – unclear, inevitably requiring an amendment of the TPA.
"*Being aware of rulings' legal implications and judicial protection is a prerequisite for their application by taxpayers*", as put forward by one consultants.

Regarding the economic factors of the instrument (time, costs, etc.), the quality and depth of views increased, due to more understandable content and wording. After more than 10 years of use, the tax authority still argues that the time for issuing tax advance rulings is appropriate and should take up to six months since their human resources are limited. This is a fact in Slovene public administration in general and FARS in particular, but it hardly complies with the importance of this tool in terms of fundamental tax principles and needs of (business) taxpayers. Moreover, it reveals a rather closed or even reluctant attitude by the tax authority to change its behaviour within the limits of the law and follow its spirit. Focusing on the legal wording of Art. 14 of the TPA, the tax authority insists that wording is clear and unambiguous, allowing a balanced protection of the public interest and assistance to taxpayers.

The several procedural mistakes made by taxpayers when applying for advance ruling were attributed merely to the lack of taxpayers' knowledge and experience, and not to unclear legal wording. This was confirmed by the tax consultants – explaining that taxpayers often hire some rather inexperienced accountants to prepare the application documentation or they even do it themselves, which is rarely adequate due to special requirements of specific transactions in both, legal and economic aspects. On the other hand, tax consultants perceive as a salient reason for such a low number of tax advance rulings in Slovenia the too demanding and long response by the tax authority, claiming costs and timing to be in most cases excessive or at least not proportionate to the value of the transaction. One tax consultant offered her experience: "*Cost-benefit analysis led my client not to apply for such a ruling again after experiencing expensive and long proceeding in which information was provided several weeks after the business opportunity had emerged*." In addition, if a taxpayer is determined to pursue the transaction regardless of the potential negative effect of receiving an adverse ruling, it is advisable not to apply for one at the first place (cf. Watson, 2016, p. 22).

According to the opinion of interviewed consultants, six months' time is unacceptably long. The majority of interviewees suggested shortening deadlines to up to two months. As far as the tax authority's fees are concerned, the consultants see them as very high, which is the reason why the instrument is not often advised to their clients. They consider both, fees and time of issuance, to be the main reasons why the instrument has not been generally accepted in Slovenia. On the contrary, the technical nature of the instrument, simplicity and better organisation of the customs office are seen as the reason for the frequent use of customs related information (such as BTIs). One of the tax consultant even explained that "*Customs office's website, forms and instructions are user friendly, while tax office regularly sends forms and documentation to foreign taxpayers in Slovene language only*." Namely, tax and customs offices merged in one office in 2014, yet there are still significant differences in their attitude towards taxpayers, with the customs service being more efficiently organised and responsive. According to the tax authority, frequent use of customs related information is a consequence of unified EU legislation and effects rather than their organisation or other grounds. Both reasons seem to be the case, and the Slovene tax authority should be more proactive in pursuing the goals of the TPA after enactment of advance ruling in 2006, as evident in other countries e.g. Austria.

Following evidence from legal analysis, selected case-law and in-depth interviews analysis, our research anticipations are confirmed. The tax advance ruling's legal nature is unclear and does not fully comply with the principle of certainty, while tax consultants perceive its legal provisions and practice as more limited than the Slovene tax authority. As revealed by a comparison of tax authority's and consultants' views (Table 2), huge differences can be

identified. This leads us to the conclusion that not only Slovene law, but also the tax authority's position contribute to the low usage of tax advance rulings in Slovenia. In this context, two main recommendations should be highlighted. The amendment of TPA should upgrade the instrument's status and legal nature. There are several nomotechnical possibilities to do so, proven as successful already in comparable countries such as Austria, Hungary or the Netherlands. Yet, the law is as good as its implementers. Consequently, the enforcement of present and potentially amended act should be improved on both sides – by the tax authority and the taxpayers. The new, modern approaches of enhanced relationship between tax administration and taxpayers should be implemented in this instrument as well, such as voluntary fulfilment of taxes by progressive taxpayers and privileged status thereof. Besides the formal, written application, the parties should meet in person to discuss important matters of the taxpayer's transaction, including time, costs, documentation and other related details. Finally, it is in the interest of both parties and public interest in terms of tax consumption to impose obligations proportionally to the economic power of the individual taxpayer and country as a whole. Tax policy, as stipulated by law and enforced in practice, is inevitably one of the key factors of business and national competiveness.

5. CONCLUSION

Tax advance ruling is a well-intended tool European wide, contributing to higher predictability of taxpayers in the economic and legal sense. However, due to national autonomy of the EU Member States, national legislatures should clearly define the goals, the procedural and substantive elements and the effects of this instrument. This is the only effective way to avoid practical counter-effects of good ideas, as shown by the illustration of the Slovene case. As established by normative analysis, comparisons, administrative statistics, case law, and empirical interviews, we can confirm both initial hypotheses on the unavoidable clarity of law regarding legal nature of the act and smooth procedure to implement it effectively by the tax authority and the taxpayers. In this context, any country should adopt clear law and secondary rules to issue information in a more useful, faster and expensive way. Only such systemic effort can lead to legal certainty and tax stability in economic transactions as well as to evolving a sustainable society.

LITERATURE:

1. Galleta, U.D., Hofmann, H.C.H., Puigpelat, O.M., Ziller, J. (2015). The *General Principles of EU Administrative Procedural Law.* Brussels: EP.
2. FARS (2017). Retrieved 12.04.2017 from http://www.fu.gov.si/.
3. Jerovšek, T., Simič, I., Škof, B. (Eds.) (2008). *Zakon o davčnem postopku s komentarjem*. Maribor; Ljubljana: Davčni izobraževalni inštitut; Davčno finančni raziskovalni inštitut.
4. Jovanović, T., Klun, M. (2017). Tax policy assessment in Slovenia - case of interest tax shield. *Danube,* 8(1), 1–17. Retrieved 20.04.2017 from (doi): 10.1515/danb-2017-0001.
5. Koprić, I., Kovač, P., Đulabić, V., Đinić, J. (2016). *Legal Remedies in Administrative Procedures in Western Balkans.* Podgorica: ReSPA. Retrieved 30.04.2017 from http://www.respaweb.eu/11/library#respa-publications-2016-7.
6. Kovač, P. (2016). Pravna narava zavezujoče informacije med teorijo in prakso. *Podjetje in delo,* 42(8), 1557–1574.
7. Kovač, P. (2012). Selected Slovene Tax Procedure Act's Simplifications and Their Implementation, *Podjetje in delo,* 38(2), 395–416.

8. Kovač, P., Bileišis, M. et al. (2017). *Public Administration Reforms in Eastern EU MS: Post-Accession Convergences and Divergences*. Vilnius; Ljubljana: MRU; FA. Retrieved 30.04.2017 from http://ebooks.mruni.eu/product/public-administration-reforms-in-eastern-european-union-member-states-postaccession-convergence-divergence.
9. Lang, M. (2010). *Procedural Rules in Tax Law in the Context of EU and Domestic Law*. Alphen: Wolters Kluwer.
10. Romano, C. (2002). *Advance Tax Rulings and Principles of Law*. Amsterdam: IBFD.
11. Supreme Court of the RS. Retrieved 20.04.2017 from www.sodnapraksa.si.
12. Tax Procedure Act, TPA (2006). *Zakon o davčnem postopku, ZDavP-2*. Retrieved 12.04.2017 from http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO4703.
13. van de Velde, E. (2015). *Tax Rulings in the EU MS*. Brussels: EP.
14. Watson, C. E. (2016). *Tax Procedure and Tax Fraud in a Nutshell*. St. Paul: West Academic Publishing.
15. Žunić Kovačević, N. (2016). Prethodna obvezujuća porezna mišljenja – novi institut hrvatskog poreznog postopka. *Zbornik PF Sveučilišta Rijeka*, 2016(1), 267–289.

LEGAL REMEDIES IN CROATIAN AND EUROPEAN LOW-VALUE PROCEDURES (BETWEEN THE LEGAL PROTECTION REQUIREMENT AND JUDICIARY EFFICIENCY)

Ivan Tironi
County Court of Split, Croatia
ivan.tironi@zsst.pravosudje.hr

ABSTRACT

Low-value procedures in Croatian procedural law are defined by three kinds of condemnatory claims set in the matters of small values. The ideal of every court case is a rightful final judgment. In this kind of cases – as socially less important – there are special procedural rules concentrated on the promptitude and efficiency of legal protection, so this can make a harmful influence on the quality of judgements. Article primarily examines the low-value procedures and their legal remedies. Because of a specific procedure in such cases, the institute of appeal as a regular legal remedy is partly arranged by different procedural rules than those rules we can find in the regular procedure. The intention of the paper is to find and suggest specific solutions (de lege ferenda) which help make legal protection more effective in due time. In this sense, taking into consideration their purpose and the fact they are of less social importance, the paper studies the possibilities of the re-interpretation of constitutional law on appeals in these kinds of acts. Considering this, there are notable legislative decisions in particular countries of the European Union: their legal systems do not allow the appeals in the cases of lower values. There is another question involved: is the request for a retrial in the light of new facts and arguments in low-value procedures allowed, because of strict legal limitations on disclosing facts and arguments in this kind of cases. The paper reviews European low-value procedures, particularly in the part of legal remedies. Finally, we discussed the appeal in such a procedure, especially from the suitor's point of view and if this procedure is used or not.

Keywords: *European low-value procedures, legal remedies, low-value disputes, request for a retrial, request for an appeal*

1. INTRODUCTION

The Civil Procedure Act (CPA) does not contain an exact definition on what low-value disputes include. However, the CPA does prescribe positive and negative criteria based on which these can be determined. Thus, the CPA determines three positive criteria for determining them, whereas the negative criterion for determining low-value disputes actually determines which disputes, regardless of other circumstances, are never considered low-value. As a result, in low-value disputes the claim refers to pecuniary claims which do not exceed 10,000 HRK, i.e. 50,000 HRK in commercial procedures, and to non-pecuniary disputes where the claimant stated *facultas alternativa* up to said amounts of 10,000 and 50,000. In addition, low-value disputes include the disputes where a pecuniary sum is not the subject of the claim, but the sale of a movable property whose value, as stated by the claimant, does not exceed 10,000, i.e. 50,000 in commercial disputes. Finally, these disputes never refer to real estate disputes, labour law disputes initiated by an employee against the decision on the termination of his employment contract and trespassing disputes (Articles 458-460 and 502 of the CPA).

The number of cases in low-value disputes is still relatively great in Croatian courts, hence the need to provide a better regulation thereof is quite understandable. Barbić reasonably notices that the passing of new regulations and amendment of the existing ones is a highly

responsible and sensitive task everywhere in the world (Barbić, 2002, p. 7). Legal regulation of low-value disputes should primarily consider two requirements - criteria. First, it should be borne in mind that these are disputes of lower social significance (considering the value criterion), which requires a higher degree of promptitude and efficiency while conducting the procedure. However, on the other hand, the desire and need for promptitude should not entirely jeopardise the basic judiciary task of the courts - to deliver a legally grounded decision. Sessa stated that procedural regulation of low-value disputes has always aimed at maintaining the balance between the requirements to conduct a prompt and efficient procedure and the requirement to provide legal protection with guarantees for the protection of the parties`s rights. Therefore, legal solutions always extended between those two extremes (Sessa, 2013, p. 1.)

The majority of modern legal systems, including the system of the Republic of Croatia, enable the parties to re-examine and verify court decisions through legal remedies, most commonly in two instances, and sometimes even in more procedural instances. The more legal remedies a certain legal system provides, the better likelihood there is that the final decision delivered in a dispute will be legally grounded. However, on the other hand, various reasons, mostly those of legal safety and cost-effectiveness, mandate that each trial has to end at one point. It particularly refers to low-value disputes due to their lower social significance. Hence, in those disputes, in terms of legal remedies (appeal in particular), there is a derogation from the procedural rules of a regular procedure.

In low-value disputes an appeal is allowed within 8 days, and only for certain absolutely essential violations of procedural provisions and erroneous implementation of substantive law. Second-instance sole judge decides on the appeal. Review in low-value disputes in allowed only in conformity with the provision of Article 382 para. 2 of the CPA. This is an extraordinary review allowed in a regular procedure against a second-instance judgement, if the decision in a dispute depends on the resolution of a substantive or procedural issue which ensures a uniform application of law and equality of all in its application.

European procedure for low-value disputes was introduced by Regulation (EC) No. 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European Small Claims Procedure (Regulation). The provision of Article 1 of the Regulation states the aims of introducing this European procedure. Its main aim is to simplify and prompt cross-border low-value disputes and to reduce the costs. This procedure is available to the parties in a dispute as an alternative to the procedure which exists in conformity with the law of the member state. Even though the provisions of the CPA referring to the European procedure for low-value disputes in conformity with the provision of Article 53 of the Act Amending the CPA (AACPA/08) entered into force on the day of accession of the Republic of Croatia into the European Union (1st July 203), it seems that, for now, the practical application of these provisions is non-existent or negligible.

2. HISTORICAL OVERVIEW

Legal regulation of low-value disputes in Croatia has been documented since the 2nd half of the 19th century. Kugler states the following: "The Act of 19th May 1917 Amending the Act on Low-Value Legal Transactions (petty disputes) of 3rd October 1876 before district courts (proclaimed in 1917 Sbornik under number 36) altered or amneded 34 paragraphs of said Act of 3rd October 1876" (Kugler, 1917, p. 1).

Special procedure for low-value disputes was also regulated by the Act on Court Procedure in Civil Matters (Civil Procedure Act) of 13th July 1929 (The Act was published in issue 179 - LXXV of the Official Gazette of 3rd August 1929). This Act, namely paragraphs 543 to 547, prescribes "Special orders regarding the procedure for low-value (petty) matters." (Agatonović, 1929, p. 353-357).

It should also be noted that, since 1933, low-value disputes were conducted only by regular courts. In 1990, they abandoned the idea to include conciliatory councils as a sort of lay courts into low-value procedures (Pravni leksikon, 2007, p. 1169).
After 1945, court practice neglected the low-value dispute believing that it contradicts the principles of the new social order, only to renew it after some time by the fourth novella of the 1956 Civil Procedure Act (Triva, Dika, 2004, p. 818).
In the last fifteen years, our legislator has altered and amended the provisions of the CPA related to low-value disputes for four times, namely by 2003, 2008, 2011 and 2013 novellas. We believe that the underlying reason is the legislator`s aim to reduce the number of these court cases.

3. LEGAL REMEDIES

3.1. Appeal

3.1.1. Appeal according to the provisions of the CPA

Appeal in the civil procedure (Germ. *Berefung im Erkentnnisverfahren*, Fren. *appel en proces civil, recourse en procedure civile*) is a general, fundamental and regular legal remedy of the parties against the first-instance court decisions. It is a general legal remedy allowed against all first-instance decisions; it is fundamental because the structure of legal remedies in a civil procedure rests upon it, and regular because the fact that it is submitted in timely manner prevents the occurrence of finality (Dika, 2008, p. 47). Considering aforementioned particularities of low-value procedures with respect to a regular procedure, it is evident that the provisions of the CPA partly derogated from the procedural regulations of the regular procedure in terms of appeal and low-value dispute decisions. It particularly refers to the reasons for contesting said decisions, because the reasons for an appeal, with respect to those from the regular procedure, are substantially reduced here. Hence, the judgement and the decision which ended low-value disputes can be contested only for specific and absolutely essential violations of civil procedure provisions, namely those provided by Article 354 para. 2, items 1, 2, 4, 5, 6, 8, 9, 10 and 11 of the CPA and for the erroneous application of substantive law. In particular, the absolutely essential violations whereby the decision in low-value disputes can be contested refer to: violation of the rule on the recusation of judges and participation of a person without judicial capacity (Article 354 para. 2, item 1 of the CPA), violation of the rules on court jurisdiction (Article 354 para. 2, item 2 of the CPA), delivery of a decision based on illicit disposal of the parties (Article 354 para. 2, item 4 of the CPA, illicit delivery of a decision based on confession, judgement based on waiver, judgement for default, judgement for absence or judgement without a trial (Article 354 para. 2, item 5 of the CPA, violation of the principle of examining the parties (Article 354 para. 2, item 6 of the CPA), violation of the rule on party and legal capacity/incapacity of the parties and the defect in their representation (Article 354 para. 2, item 8 of the CPA), existence of procedural obstacles for adjudication (Article 354 para. 2, item 9 of the CPA), violation of the principle of public exposure (Article 354 para. 2, item 10 of the CPA), and violations leading to circumstances under which a decision cannot be examined (Article 354 para. 2, item 11 of the CPA). Hence, in these kinds of procedures (as opposed to the regular ones) it is not allowed to file an appeal for relatively essential procedural violations, absolutely essential violations of the CPA provisions, namely those provided by Article 354 para. 2, items 3, 7, 13 and 14 of the CPA, or an appeal for erroneous or incomplete establishment of facts. After reviewing many second-instance judgements in low-value disputes, it seems that second-instance courts sometimes, obviously trying to circumvent the strict rules disallowing the filing of an appeal due to relatively essential procedural violations or erroneous and incomplete establishment of facts, abrogate the first-instance decisions delivered in these disputes by referring to the absolutely essential procedural violation provided by Article 354 para. 2, item 11 of the CPA,

although such violation was not committed by the first-instance court. Even though such sporadic behaviour of some second-instance judges, presumably guided by a noble goal to make all judgements fair, is not common, we still believe it is necessary to draw attention to it and proclaim it inadmissible. Derogation from the general rules on the right to an appeal against a decision is achieved by Article 467 paras. 1 and 2 of the CPA. Hence, low-value dispute allows a special appeal only against a decision ending the procedure. Other decisions against which the CPA allows appeals can be contested only by an appeal against a judgement ending a procedure. The deadline for filing an appeal against a judgement or a decision ending a procedure for low-value disputes, in conformity with the provision of Article 467 para. 3 of the CPA, is 8 days (reduced with respect to the 15-day deadline as a general rule in the regular procedure). This deadline is counted from the day of announcement of the judgement or a decision, and if the judgement or a decision have been delivered to the party, the deadline is counted from the delivery date (Article 467 para. of the CPA). Numerous practitioners have noticed that said provision is vague, because it causes trouble with the interpretation of the timeliness of the appeal. In fact, it raises the question whether a disgruntled party, if the judgement has been announced, has to file an appeal even though they did not receive the judgement, i.e. whether the judgement needs to be delivered to the parties if it was announced, considering that the deadline for an appeal is counted from the announcement date. Court practice has yet to provide answers to these issues. Some authors state that it is probably an editorial error which occurred when the AACPA/8 deleted the provision on delivering a copy of the judgement to a party present at the announcement only at the party`s request, and that the provision was a practical and good solution (Jakovina, 2012, p. 257). In fact, pursuant to Article 466 para. 2 of the CPA which was valid before the AACPA/8 entered into force, the copy of the judgement was delivered to the party present at the announcement only at that party`s request, and the request could be made at the announcement hearing the latest. It is worth mentioning that, in regard to the regular procedure, the Act Amending the Civil Procedure Act (AACPA/13), namely the provision of Article 73, substantially altered Article 335, hence the provision of paragraph 4 of this Article prescribes that the judgement has to be issued, announced, composed and delivered or sent no later than 45 days from the conclusion of the main hearing. In any case, we believe that the procedures for low-value disputes have to grant the party a right to a written copy of the judgement. The deadline for an appeal would be counted from the receipt thereof, and the party could also waive said right. Otherwise, if the deadline for an appeal would be counted from the announcement date, the party would write an appeal without knowing the specific reasons for the delivery of the contested judgement. The fact that the appeal in low-value disputes cannot be filed due to erroneous or incomplete establishment of facts does not imply that the party could write an appeal, whether they received the judgement or not. In fact, neglecting the party`s right to a written copy of the judgement, and withholding specific reasons thereof from the party, may overstep the boundary beyond which there would be no more reasonable guarantee that the party will realise their right to an appeal in an acceptable and quality way. In view of the above, we believe it is necessary *de lege ferenda* to alter and amend the provisions of the CPA regulating this legal matter so as to unambiguously define the possibility for a party in this procedure to realise their right to a written copy of the judgement (if the deadline for an appeal is counted from the delivery date of the written copy of the judgement), and allow the party to waive that right. In that case, the deadline for an appeal could be counted from the announcement date. It should be emphasised that the erroneous instruction on the appeal deadline should no be to the detriment of the party who complied with such instruction and filed the appeal within the deadline stated in the instruction. Appeal thus filed is considered timely.

This is also the legal standpoint of the Civil Department of the Supreme Court of the Republic of Croatia adopted at the department meeting held on 25th February 2008.

3.1.2. Right to an appeal

The provision of Article 18 para. 1 of the Constitution of the Republic of Croatia (RC Constitution) prescribes that the right to an appeal against certain legal acts filed in the first-instance procedure before the court or a competent authority is guaranteed. Considering such broad view of the constitutional right to an appeal, some authors who criticised such regulation claim that our legal order guarantees this right in a very "generous manner" (Uzelac, 2013, p. 222). Unlike the RC Constitution, European Convention for the Protection of Human Rights and Fundamental Freedoms (Convention) has a substantially narrower view of the right to an appeal. The original text of the 1950 Convention did not even contain the right to an appeal as a human right; the right to an appeal was introduced in 1984 by passing Protocol 7, which prescribes the right to an appeal only in criminal proceedings. Therefore, bearing in mind aforesaid lower social significance of these procedures in low-value disputes (with respect to the value criterion), and the fact that they are vastly represented in Croatian courts, we believe that the following question is legitimate. Would it be justified to additionally limit or entirely exclude the right of the parties to an appeal in such procedures? In fact, it would reduce the number of these cases in our courts, whereby the judges and the court advisers would have more time to work on "more serious" cases, but such legal solution would additionally jeopardise the quality of legal protection. Before answering this question, we need to review the legal solutions from several European countries with rich legal tradition, i.e. with a well-regulated judicial system.

3.1.3. Appeal in comparative law

With respect to low-value disputes, Europe is dominated by two systems of limited right to an appeal: the system where the possibility to contest a decision before a second-instance (appellate) court is entirely excluded and the system where such contestation is allowed, but is limited only to some appellate reasons, usually to violations in the application of a law or which are limited by the need to procure a court approval for filing a legal remedy (Uzelac, 2013, p. 226).

F.R. Germany is an example of the first system country. The provision of Article 511 of the German Zivilprozessordnung (ZPO) prescribes that an appeal is allowed only if the contested part of the first-instance judgement does not exceed 600 EUR, and for lower amounts only if the first-instance court allows it in its judgement. Said Article determines that the court may grant an appeal only if the subject matter of the dispute has a nominal significance, i.e. if it is important for the development of the law or if it ensures uniform legal practice (Baumbach, 2017, p. 1797).

In France, an appeal against civil procedure judgements is allowed, unless otherwise prescribed. It is not allowed in cases where, for instance, the first-instance court decides on the matters from its own exclusive jurisdiction whose value is up to 4,000 EUR. In that case said court would act as a "court of first and last instance" (Uzelac, 2013, p. 226).

The Republic of Austria is an example of the second system country in terms of the limitation of the right to an appeal. Hence, in conformity with the provision of Article 501 of the Austrian Zivilprozessordnung, it derives that appellate reasons in the low-value disputes (up to 2,700 EUR) are limited only to absolute invalidity and erroneous application of substantive law (Rechberger, 2010, p. 575).

3.1.4. Final deliberation on appeals

Consequently, in terms of the limited right to an appeal in low-value disputes, we find the legal solution of the German ZPO acceptable. We are aware that such or similar legal solutions imply a completely regulated judicial system and respectable quality and expertise of judges. This is something that the Republic of Croatia still needs to strive towards. Therefore, we may need to wait a certain time to accept said legal solutions from the German procedural act, in order to improve the organisation of judiciary and the quality of judicial corpus. If we immediately reach for said procedural solutions from the German ZPO, we may need to set the value criteria for the admissibility of the appeal below 600 EUR, e.g. to 3,000 HRK, which would be better suited to our economic circumstances and the standard of living.

3.2. Review

Review is an extraordinary legal remedy filed against the second-instance decisions whereby the procedure is finally concluded (Dika, 2010, p. 258).

The provision of Article 467a para. 1 of the CPA prescribes that low-value disputes allow only the review from Article 382 para. 2 of this Act, and only if the second-instance court allowed an appeal in its dictum. This refers to an extraordinary review allowed in the regular procedure, if the decision depends on the resolution of a substantive or procedural issue relevant for ensuring a uniform application of law and equality of all in its application. In conformity with the provision of Article 467a para. 2 of the CPA, in the rationale of the judgement allowing an extraordinary review, the second-instance court needs to specify the underlying legal issue and present the reasons why it believes that it would be important for ensuring a uniform application of law and equality of all.

3.3. Motion for retrial

Motion for retrial is an extraordinary and nominally non-suspensive legal remedy against a decision finally concluding the procedure, which can be filed for certain absolutely essential violations of civil procedure provisions, for some criminal offences and regular and certain qualified novelties. It is decided upon by the first-instance court (Dika, 2010, p. 350).

In the context of the issue of legal remedies in low-value disputes, bearing in mind the admissible appellate reasons in this type of procedure, (the decision in low-value disputes cannot be contested for erroneous or incomplete establishment of facts), and the fact that facts and evidence in these disputes can, in general, be presented until the moment of filing an appeal, i.e. until the response to a claim (Article 461a para. 2 of the CPA), i.e. exceptionally at the preliminary hearing (para. 3 of said Article), we believe that it is essential to answer the question as to whether in these types of procedures the motion for retrial is nominally allowed and up to what moment the facts should occur for the court to grant retrial. Hence, the following needs to be emphasised.

The provision of Article 421 para. 1 item 10 of the CPA prescribes that the procedure finally concluded by a court judgement may be repeated at the party`s proposal, if the party becomes aware of any new facts or finds and acquires a possibility to use new evidence based on which a more favourable decision could have been made for the party, had such facts or evidence been used in the previous trial. For that reason, a retrial may be granted only if the party, through no fault of their own, was unable to present such facts and evidence before the previous trial was finally adjudicated (Article 422 para. 1 of the CPA).

In terms of defining new facts, literature mentions subjective and objective novelties. Subjective novelties refer to those facts which occurred until the moment to which the judgement finality applies, but the appellant became aware of them later. Objective novelties are those which occurred after that moment (Bulka, 2016, p. 19).

Bearing in mind the predefined length of this paper, we will only emphasise that we side with those authors who find it justified to accept the standpoint about the admissibility of the motion for retrial in these types of procedures due to new facts and evidence, regardless of the fact that an appeal cannot be filed due to erroneous or incomplete establishment of facts. Benzon/Vujeva state the following to support this legal standpoint: "The possibility of abuse is prevented by the provision of the CPA according to which a retrial for said reason may be allowed only if the party, through no fault of their own, was unable to present new facts and evidence before the previous trial was ended by a final court decision (Article 422 para. 2 of the CPA). In addition, the list of new facts for which the court my grant the motion for retrial is also limited. In low-value disputes, the court could allow the motion for retrial only due to new facts which the party could have presented by the end of the previous trial, but failed to do so through no fault of their own. In view of the above, the court should not grant the motion for retrial due to new facts and supporting evidence, if they could not be presented by that moment in the first-instance procedure, since they did not objectively exist or they existed, but were not presented due to the party`s fault." (Benzon, 2015, p. 43).

4. LEGAL REMEDIES IN THE EUROPEAN PROCEDURE FOR LOW-VALUE DISPUTES

We have already sated the purpose, manner and time of introducing the Regulation. Low-value procedure has been available to EU member states since 1st January 2009 and it has been applied in conformity with the provision of Article 29 para. 2 of the Regulation ever since. Pursuant to the provision of Article 2 of the Regulation, it is applied in cross-border civil and commercial matters, regardless of the type of the court, when the value of the claim does not exceed 2,000 EUR at the moment when the claim form has been received by the competent court, excluding all interests, expenses and fees. In this paper, we have explicitly listed the types of disputes to which the Regulation does not apply. The provision of Article 3 of the Regulation defines the notion of a cross-border case determined as a case in which at least one party has a domicile or habitual residence in the EU member state, which is not the state where the court is located. The notion of "member state" refers to all member states of the EU, except for Denmark (Article 2 para. 3 of the Regulation). Pursuant to the provision of Article 7 of the Regulation, the judgement must be delivered within 30 days from the receipt of the parties` response (Article 5 para. 3 or 6), and it is not announced, only delivered.

The institution of legal remedies in the European procedure for low-value claims is regulated by the provision of Article 17 of the Regulation. It prescribes that the member states notify the Commission about whether a legal remedy is admissible, according to their procedural law, against a decision delivered in the European procedure for low-value disputes, and about the deadline for its submission. The Commission publishes such information. Hence, the Regulation applies the *lex fori* rule to the decision whether a legal remedy is allowed against the judgement. However, the provisions of Article 18 of the Regulation titled "Minimal standards for re-examining the decision" guarantee the right to the defendant to request the re-examination of the decision in the European procedure for low-value disputes before the competent court of the member state where the decision was delivered, if the defendant states that his rights were not sufficiently respected. In particular, the defendant, in conformity with Article 18 of the Regulation, is entitled to that right if the claim form or the summons were delivered without any proof of personal delivery and if, through no fault of the his own, the delivery was not performed in a timely manner which deprived him of sufficient time to prepare his defence, i.e. if the defendant was unable to object to the claim due to *force majeure* or extraordinary circumstances which occurred through no fault of his own, provided that he acted promptly in any of these cases. We should emphasise that the judgement

delivered in this European procedure is enforceable before it became final in the state where it was delivered (Article 15 of the Regulation).

Our legislator introduced the provisions regarding the European procedure for low-value disputes into the AACPA/8, which created the conditions for immediate application of the Regulation. Hence, the 2008 CPA novella was used for the harmonisation of the Croatian law with the provisions of the European *acquis communautaire* regarding the legal cooperation in civil matters (Sikirić, 2008, p. 103). The rules of the European procedure for low-value disputes were incorporated into the CPA by the provisions of Articles 507 to 507ž. It should be emphasised that the provision of Article 507š of the CPA prescribes that, if the defendant provides credible assumptions for the re-examination of the judgement delivered in the European procedure for low-value disputes, in conformity with the provisions of Article 18 para. 1 of the Regulation No. 861/2007, the court will proclaim said judgement invalid and return the procedure to the point at which it was before such judgement was delivered. The provision of Article 507t of the CPA prescribes that the appeal against a judgement delivered in the Republic of Croatia in the European procedure for low-value disputes does not postpone enforcement.

An interesting fact is that, according to a research conducted in the Republic of Croatia in 2015, not one case was reported in our practice where the provisions regulating the European procedure for low-value disputes were applied (Benzon, 2015, p. 47). However, it appears that the situation with the application of the Regulation is no better in other EU countries either. Some authors claim that the Commission is aware that the procedure for low-value disputes is not quite known and rarely used. The relevant statistical data was provided by the report issued by the European Consumer Centres Network (IP/12/985) in September 2012, hence the Commission is working with the member states on making the procedure better known (Hau, 2013, p. 223).

5. CONCLUSION

The delivery of unlawful decisions jeopardises the objectives of the legal order (legality and fairness) and questions legal safety, which results in reduced trust of legal subjects - parties in the judicial system. In order to prevent such consequences, in addition to other resources, the legislator can also resort to other systemic options of examining the regularity of procedures and legality of court decisions. In that sense, the Republic of Croatia, like the majority of other legal systems, allows the parties to re-examine and verify court decisions through legal remedies. In low-value disputes, the possibilities of applying legal remedies (in terms of type and reasons) are substantially reduced with respect to the regular procedure, most likely due to their lower social significance in terms of the value criterion. Despite frequent interventions of the legislator into the provisions of the CPA referring to low-value disputes, the courts still face a great number of these cases. It is, therefore, necessary to re-examine certain legal solutions regulating the institution of legal remedies, especially the appeal, in these types of procedures, in order to achieve greater efficiency of the court on the one hand, and, on the other hand, to remain within the limits of a reasonable guarantee that the party would achieve at least a satisfactory quality of legal protection in this type of summary proceeding. In that sense, our paper offers a draft of a legal solution (in the foreseeable future) modelled after the German ZPO, whereby the CPA would set the limit of 3,000 HRK as the criterion for appeal admissibility.

Despite the current status where the citizens do not resort to the European procedure for low-value disputes, we expect that it will come to that in the foreseeable future, especially by the consumers and small-size enterprises, which were the target group of this procedure in the first place. It remains to be seen whether this procedure will become the basic model for delivering a future European civil procedure in the foreseeable future.

LITERATURE:

1. Agatonović, A., F. (1930). Građansko zakonodavstvo, Knjiga I. - Zakon o sudskom postupku u građanskim parnicama (Građanski parnični postupka) za Kraljevinu Jugoslaviju od 13. jula 1929. Zagreb: Themisova izdanja.
2. Barbić, J. (2002). Hrvatska i vladavina prava, in Pusić, E. (ed.) Rad, knjiga 40. Zagreb: Hrvatska akademija znanosti i umjetnosti, razred za društvene znanosti. p. 5-30.
3. Baumbach, A., Lauterbach, W. Albers, J., Hartmann, P. (2017). Zivilprozessordnung mit FamFG, GVG und anderen Nebengesetzen. Munchen: C.H. BECK.
4. Benzon, I. Vujeva, M. (2015). Postupak u sporovima male vrijednosti, Analiza procesnih instituta u teoriji i praksi nakon Novele Zakona o parničnom postupku iz 2013. Zagreb: Pravnik, 48, 1 (98). pp. 23-52.
5. Bulka, Z., Jakovina, D. (2016.) Sporovi male vrijednosti. Zagreb: Obrazovni materijal Pravosudne akademije.
6. Dika, M. (2008). Žalba protiv presude donesene u redovnom parničnom postupku nakon novelSe Zakona o parničnom postupku iz 2008. in: Dika M. et al. (ed.), Novela Zakona o parničnom postupku iz 2008., Savjetovanje, Zagreb, 13. listopada 2008., radni materijali. Zagreb: Narodne novine. pp. 47-78.
7. Dika, M. (2010). Građansko parnično pravo, Pravni lijekovi. Zagreb: Narodne novine.
8. European Convention for the Protection of Human Rights and Fundamental Freedoms, Narodne novine, Međunarodni ugovori, 6/99.
9. Hau, W. (2013). Europski postupak za tražbine male vrijednosti u Europsko građansko procesno pravo-Izabrane teme. Zagreb: Narodne novine. pp. 213-226.
10. Jakovina, D. (2012). Sporovi male vrijednosti, in Godišnjak 19., Hrvatsko društvo za građansko pravne znanosti i praksu, Zagreb: Organizator. pp. 233-264.
11. Kugler, M. (1917). Tumač maličnom postupku, Zagreb: Naklada Kr. Zem. Vlade Odjela za pravosudje.
12. Pravni leksikon, (2007). Zagreb: Leksikografski zavod Miroslav Krleža.
13. Rechberger, W. H., Simotta, D.-A. (2010). Grundriss des osterreichischen Zivilprozessrechts Erkenntnisverfahren, Wien: Manzche Verlags - und Universitatsbuchhandlung.
14. Regulation (EC) No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European Small Claims Procedure. O. J. 2007 L 199/1.
15. Sessa, Đ. (2013). Sporovi male vrijednosti nakon Novele ZPP-a iz 2013., Referat, Izvorno.
16. Sikirić, H. (2008). Europski parnični postupci Pravosudna suradnja u Građanskim predmetima u Novela Zakona o parničnom postupku, in Dika M., (ud.), Radni materijali – Savjetovanje - Zagreb 2008., Zagreb: Narodne novine. pp. 101-126.
17. Triva, S., Dika M. (2004). Građansko parnično procesno pravo, Zagreb: Narodne novine.
18. Ustav Republike Hrvatske, Narodne novine, 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 5/14
19. Uzelac, A. (2013). Ustavno pravo na žalbu u građanskim stvarima: jamstvo ispravnog pravosuđenja ili relikt prošlosti? in Uzelac A., Garašić J., Maganić, A. (ed.), Djelotvorna pravna zaštita u pravičnom postupku, Izazovi pravosudnih transformacija na jugu Europe, Liber Amicorum Mihajlo Dika. Zagreb: Pravni fakultet Sveučilišta u Zagrebu. pp. 219-243.
20. Zakon izmjenama i dopunama Zakona o parničnom postupku, Narodne novine, 25/13
21. Zakon o izmjenama i dopunama Zakona o parničnom postupku, Narodne novine, 117/03
22. Zakon o izmjenama i dopunama Zakona o parničnom postupku, Narodne novine, 84/08
23. Zakon o izmjenama i dopunama Zakona o parničnom postupku, Narodne novine, 57/11
24. Zakon o parničnom postupku, Narodne novine, 53/91, 91/92, 58/93, 112/99, 88/01, 117/03, 88/05, 2/07 - Odluka USRH, 84/08, 96/08 - Odluka USRH, 123/08, 57/11, 148/11 - pročišćeni tekst, 25/13 i 89/14 - Odluka USRH
25. Zakona o izmjenama o dopunama Zakona o parničnom postupku, Službeni list SFRJ 23/72

ROLE OF TAX REVENUE OF LOCAL SELF-GOVERNMENT UNITS IN CORELATION TO FISCAL DECENTRALISATION

Emina Jerkovic
Faculty of Law Osijek, University of Josip Juraj Strossmayer in Osijek, Croatia
ekonjic@pravos.hr

ABSTRACT

Fiscal federalism is relevant part of the theory of public finances which deals with problems of decision making process, capabilities of assessment of liability for taxation and usage of collected means in public sector with two or more levels of fiscal government. Use of fiscal decentralisation in theory and in practise varies from each country to another. It is dependant of system of government, territorial constitution, economic and social development, historical and political circumstances which in the end determine entire configuration of public finances.

Which sources of fiscal revenue, in what capacity and in what way to distribute are the main problems that all states encounter frequently. On the one hand problem often lies in collection of taxes or the lack of it and on the other hand on how to properly and productively invest collected tax revenue and how it refflects on the economic development and growth of local self-government units. This paper deals with the revenue of the local and regional self-government units, focusing on the issue of tax revenue and the related types of taxes, furthermore provides a complex approach regarding the different structures of state and self-government revenues. Accordingly, by presenting the requirements of the European Union and the related experience, it reviews the basic elements of the Croatian tax system. The local and central characteristics of the certain types of taxes and the specialities thereof, as well as the applied functional differences are also scrutinized, and a widely accepted opinion of the taxpayers is explained.

Keywords: *fiscal decentralisation, local self-government unit, tax revenue*

1. INTRODUCTION

The trend of decentalisation of the state is strengthening in the whole world. Usually it is defined as transfer of political power and influence from higher level of government (cental state) to lower levels of government (regional and local self-government units). The process of decentralisation differs from state to state, but the one thing they all have in common is the need for more successfull public sector. With the process of decentralisation of public services we decide how to please in the optimal way residents of each local self-government unit because the local government has the best insight for pleasing different local interests needs fir public goods and services. Consequently, one of the most important benefits is the higher efficiency of providing public needs and services.

The others goals that can be achieved by fiscal decentralisation are reduction of share of public sector in the whole economy, mobilising public revenue and at the same time reducing costs of provision of public services, adjustment of responsibilities for local expenditures with available financial means, strengthening of own revenue of local self-government units and promoting the cooperation of different levels of government in providing public services.(Jurlina Alibegović, 2003, pp. 93-94)

The trend of decentalisation of the state is strengthening in the whole world. Usually it is defined as transfer of political power and influence from higher level of government (cental state) to lower levels of government (regional and local self-government units). The process of decentralisation differs from state to state, but the one thing they all have in common is the

need for more successfull public sector. With the process of decentralisation of public services we decide how to please in the optimal way residents of each local self-government unit because the local government has the best insight for pleasing different local interests needs fir public goods and services. Consequently, one of the most important benefits is the higher efficiency of providing public needs and services.
The others goals that can be achieved by fiscal decentralisation are reduction of share of public sector in the whole economy, mobilising public revenue and at the same time reducing costs of provision of public services, adjustment of responsibilities for local expenditures with available financial means, strengthening of own revenue of local self-government units and promoting the cooperation of different levels of government in providing public services.

2. HISTORY OF FISCAL DECENTRALISATION

The goal of every state decentralisation is to recognize and please the public needs and to encourage local and regional development. Only by achieving those goals of decentralisation can the state create motivation and satisfaction of its citizens for contributing to accomplishment of public affairs. In the Republic of Croatia decentralisation presents itself through three levelsof government. We talk about the highest level, i.e. the state, the middle regional level, i.e. counties (20 of them) and the third local level, i.e. cities and municipalities (556 of them). Each of the fiscal levels has its powers and responsibilities.
The idea of local self-government dates back to a tradition of centuries in Europe. Local self-determination and exercise of power, although to different extends, appeared both in the concept of the Scandinavian 'tingsted' (i.e., locality, the materialized expression of local autonomy in the early Middle Ages) and the British 'devolution' (i.e., decentralization of central authority). Marked differences and delimiting characteristics can be observed in both the horizontal and vertical structures of existing local self-governments of individual European countries, which developed with different characteristics. The systems having unique traits, despite the small and large differences, however, can be categorized according to the local government development path: they can be classified as per their formation, history, and related traits. Accordingly, European development path of local authorities draws up three main self-government models: the northern, the Napoleonic (Latin), as well as the intermediate model.
The models can be separated according to the level of autonomy. In the north, the Nordic model is the type of public administration based on stronger local self-governments, which fulfils traditionally a higher number and more significant public tasks, exercises wider powers providing considerable autonomy and allows greater flexibility (including, inter alia, Sweden, Denmark, Finland, Norway, Belgium, the Netherlands, Great Britain and Ireland) (Ercsey, et. al., 2012, 222) The Napoleonic (or Latin) model compared to this grants a limited degree of autonomy to local governments (e.g., France, Spain, Italy, Greece and Portugal). The intermediate model is between these two types, by achieving local governments of medium level of power (such as Germany, Austria, Switzerland and Belgium).
The Croatian self-government systems belong to the intermediate model of the three basic types of self-governments according to economic autonomy and funding aspects. Croatian model follows the European trends, since the types move toward each other, and, as a result of European unification, the elements, which could be separated earlier, converge due to the unifying principles.
The local government models show a number of differences, however, certain similarities, some traditional values occur in all countries. Certain values are specified by the legal regulation of every EU Member State, and are also declared by the European Charter of Local Self-government (hereinafter referred to as the Charter) accepted by the Council of Europe.

Article 9 – which includes eight sections – (Financial resources of local authorities), the longest part of the Charter, regulates the finances of local governments. It provides detailed guidelines on local self-governments, and contains the following financial and economic management principles:

- principle of income: the local authorities are entitled to their own financial resources, of which they may dispose freely within the framework of their powers;
- local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the corresponding law (the principle of entitlement to the financial resources adequate to the responsibilities);
- the principle of local taxation powers (local taxation rights, and the right to introduce other local payment obligations; part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate);
- reduction of financial disparities between the local self-government units (so-called equalization principle);
- the use of funds as per the statutory limits (the principle of expenditure);
- as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects (the limitation of earmarked funds);
- the autonomy of management decisions within their own jurisdiction (principle of discretionary powers);
- participation in the central decision-making concerning local self-government finances (principle of participation).

The most important principle is the entitlement to appropriate financial resources, which means, on one hand that the volume of municipal funds shall be commensurate with the extent of local government responsibilities set forth in the corresponding law in the legislation and, on the other hand, the amount of funds allocated at the local self-governments can be considered as appropriate, if they keep pace with the cost of carrying out their tasks (Paragraph 4 of Article 9 of the Charter).

It is in accordance with the single European principles and unifying trends, that Croatia developed its tax system in compliance with the requirements of the European Union, by fulfilling the related harmonization tasks. The current Croatian tax system can be examined through three fiscal levels. This paper deals especially with tax revenue of local and regional self-government units, by presenting the way of realizing tax revenue, levying and collecting taxes, furthermore satisfying public needs on state, county and city levels.

Since the declaration of its independence, the Republic of Croatia has commenced thorough reconstruction of its tax system as well, since it had to meet the requirements of the new political system terminating the war period, as well as the challenges of market economy closing the socialist character. Essential tax reforms have brought the system closer to systems of the EU Member States, through its harmonization with taxation systems of developed European countries.

3. SCOPE OF AUTHORITY OF LOCAL AND REGIONAL SELF –GOVERNEMNT UNITS

Law on Local and Regional Self-Government regulates the scope of functions of municipality and city separated from the scope of functions of county. Pursuant to the provision of Article 19 of the Law, local and regional self-government units in their self-governing scope perform the tasks of local importance, and especially see to jobs that are not constitutionally or legally assigned to government bodies, relating to the planning of settlements and housing, spatial and urban planning, social welfare, primary health care, education, etc.

3.1. The powers and responsibilities of counties

County conducts services of a regional importance, and which are not assigned by the Constitution and laws to the national authorities. The incidence of county can be original (self-governing) and entrusted to (services of state administration).

County in its self-management scope performs services relating to:

- education
- health care system
- spatial and urban planning
- economic development
- transport and transport infrastructure
- maintenance of public roads
- planning and development of a network of educational, health, social and cultural institutions
- issuing construction and location permits and other documents related to construction and implementation of spatial planning documents for the county outside the big city
- other activities in accordance with special laws.

By the decision of the representative body of local self-government unit in accordance with its statute and the statute of the county, some jobs of self-government scope of the municipality or city can be transferred to the county.

Entrusted services relate to services of state administration which are carried out by a county and are defined by law. The costs of these services shall be paid from the state budget.

3.2. The powers and responsibilities of cities an municipalities Municipalities and cities in their self-governing domain (scope) perform the services of local importance which directly actualize the needs of citizens, which are not assigned by the Constitution and laws to the national authorities and in particular services related to:

- planning of settlements and housing
- spatial and urban planning
- utility services
- childcare
- social care
- primary health care
- education and primary education
- culture, physical culture and sport
- consumer protection
- protection and enhancement of natural environment
- fire and civil protection
- traffic in their area
- other activities in accordance with special laws.

To meet its duties, counties, cities and municipalities have to find means of finance- mostly deriving from public revenue. When we talk about financing local and regional self.government units most often we talk about fiscal capacity and its strenght. Fiscal strenght of these units varies a lot especially when it comes to municipalities and cities.

4. REVENUE OF LOCAL AND REGIONAL SELF –GOVERNEMNT UNITS

Financing of local and regional self-government units in decentralized countries is of great importance, both for the development of the overall economy, as well as for the development of local and regional self-government units which carry out the logic of polycentric

development. To satisfy this postulate it is necessary to find the optimal method of financing- Local and regional self-government units in their budgets have to ensure revenue which are proportional to expenditures, from its own sources, of shared taxes and grants from state and county budgets.

Revenue of local and regional self-government units:

1. Income from movable and immovable objects in their possession
2. Income from companies and other entities owned and revenue from concessions granted by local self-government units
3. Revenue from the sale of movable and immovable objects in their possession
4. Gifts, inheritances and legacies
5. Municipal, town and county taxes and fees and duties, whose rates, within the limits specified by law, are determined independently
6. Government assistance and grants provided by the state budget or a special law
7. Compensation from the state budget for performing services of the state administration, which were conveyed to them
8. Other revenue determined by law.

4.1. County and municipal/city revenue

Law on Financing of Local and Regional Self-Government Units and Law on local taxes determine the resources of funds and financing services from the scope of the counties, municipalities and cities.

a) County revenue

1. Revenue from own property
a) Income from movable and immovable objects in the possession of the county
b) Income from companies and other entities owned by the county
c) Revenue from the sale of movable and immovable objects in the possession of the county
d) Gifts, inheritances and legacies

2. County taxes
a) Inheritance tax
b) Tax on motor vehicles
c) Tax on boats
d) Tax on gaming machines

3. Fines and confiscated assets for the offenses that are prescribed by the county itself

4.Other revenue determined by special law.

b) Municipal and city revenue

1. Revenue from own property
a) Income from movable and immovable objects in the possession of the municipality or town
b) Income from companies and other entities owned by the municipality or town
c) Revenue from concessions granted by local self-government units

d) Revenue from the sale of movable and immovable objects in the possession of the municipality or town
e) Gifts, inheritances and legacies

2. Municipal and city taxes
a) Surtax to income tax
b) Tax on consumption
c) Tax on holiday homes
d) Tax on sales on real estate
e) Tax on public land use

3. Fines and confiscated assets for the offenses that are prescribed by the municipality or town themselves.
4. Administrative fees in accordance with a special law
5. Residence fees in accordance with a special law
6. Utility charges for the use of municipal or city facilities and institutions
7. Utility charges for the use of public or municipal urban areas
8. Other revenue determined by special law.

4.2. Shared taxes

There is one very important category of public revenue that we must emphasise- shared taxes. Shared tax is personal income tax. The most important remark dealing with shared taxes is revenue belonging, so which unit of the public administration the revenue belongs to.
Personal income tax is the most significant revenue especially when it come s to cities and municipalities.
Revenue from income tax is divided between:

- municipality/city - 60%
- county - 16,5%
- part for decentralized functions - 6%
- part for position for aid of accommodation for decentralized functions - 16%
- part for position for aid for project co-financed with funds of European structural and investment funds, project managers being municipalities, cities and counties - 1,5%.

Decentralized functions are social care, education, health care and fire department. But it is very important to emphasize that the operational side of these functions is financed through Personal income tax. When it comes to personal income of people employed or taking care of these functions, their income derives from state budget. Operational side includes mostly material costs (buildings, equipment, furniture etc.) in connection to performing these functions.
Primary goal of every local self-government unit is to provide satisfactory level of public services to its citizens, but we have to bear in mind that many of the local self-government units do not dispose of adequate own revenue for financing locel public services. So the central state has to ensure adequate system of fiscal accomodation which needs to settle part of the means that are missing to succesfully satisfy all of the local public needs. Issues of fiscal accomodation are being delt with in the way that part of revenue collected from the personal income tax is extracted for decentralized functions in primary and secondary education, social care, health care and fire department (i.e. 6%). Local self-government units that do not earn enough revenue for financing those decentralized functions get part of the revenue collected from the personal income tax for position for aid of accommodation for decentralized functions (i.e. 16%)(Jurlina Alibegović, 2003, pp.96-97)

5. STRUCTURE OF TOTAL REVENUE OF LOCAL AND REGIONAL SELF-GOVERNMENT UNITS

Total revenue of local and regional self-governement units amounted to 16,1 billion HRK in 2014 which represents an increase of 1,1 % by comparison with 2013.
Most aboundant revenue of local and regional self-governement units are tax revenue. Tax revenue reached 11,5 billion HRK which makes 71,8% of total revenue of local and regional self-governement units. By comparison with 2013. tax revenue increased by 0,8%.

Revenue relised from state aid reached 2,3 billion HRK, i.e. 8,6% more tjan in 2013. So their share in the total revenue of local and regional self-governement units amounts to 14,1%.

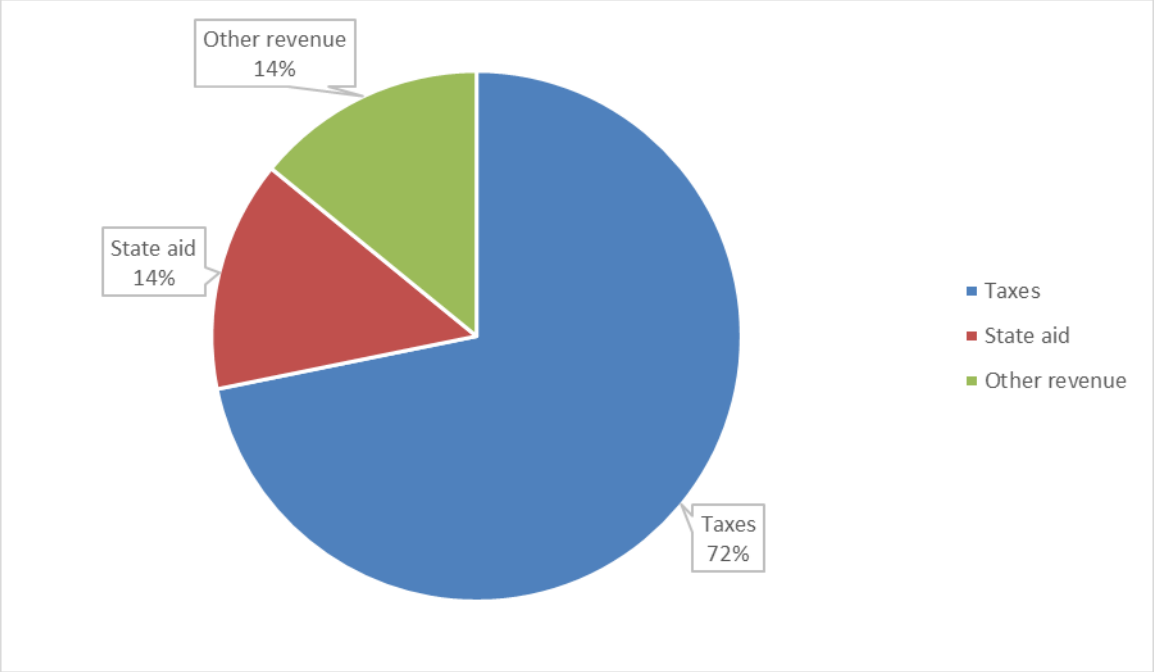


Chart 1: Structure of total revenue of local and regional self-government units in 2014. (Ministry of finance: http://www.mfin.hr/adminmax/docs/Godisnjak%202014..pdf, p. 66.)

When we look at the structure of tax revenue we can see that the biggest share hold the revenue from personal income tax and revenue from surtax to personal income tax – 78,7 %. They are followed by property tax that amounts to 16,1% of total tax revenue of local and regional self-governement units.

Chart following on the next page

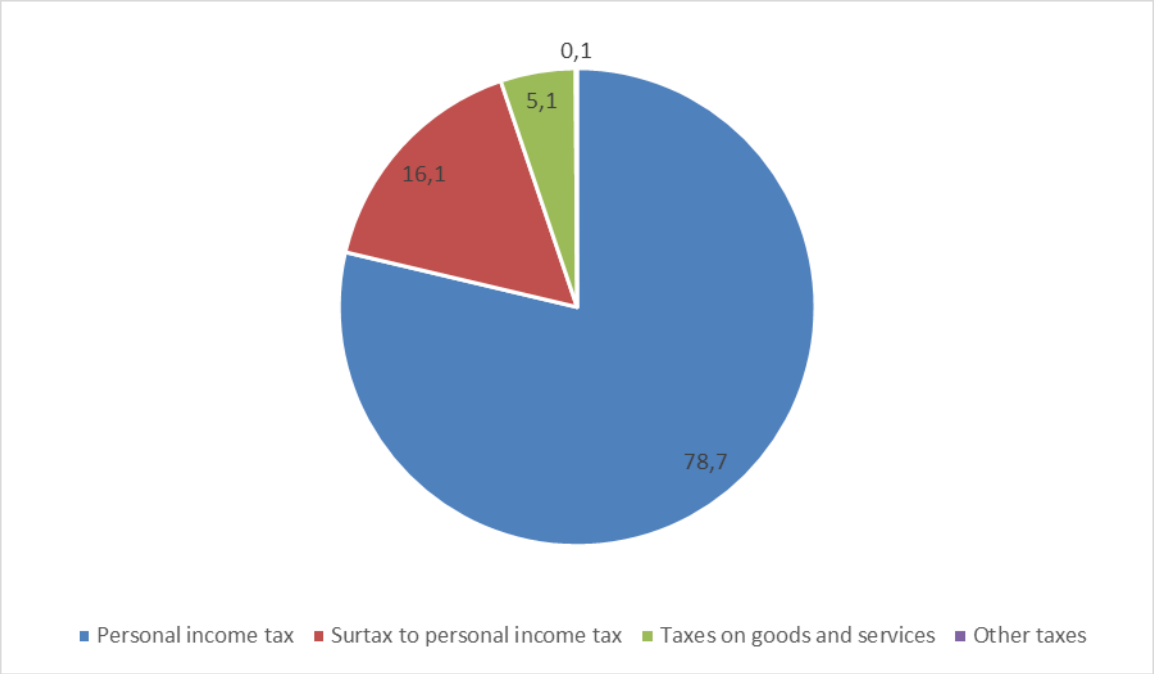


Chart 2: Structure of tax revenue of local and regional self-government units in 2014. (Ministry of finance: http://www.mfin.hr/adminmax/docs/Godisnjak%202014..pdf, p. 66.)

6. HORIZONTAL COMPETITION AND UNPAID REVENUE AND THE STATE OF LOCAL FINANCES

Governments situated on the same level of a multilevel government system compete with one another as well as with those higher or lower hierarchy. (Salmon, 2006, 61) This is known as horizontal competition which affects many aspects but one of the most important is economic growth of certain self-government units. Law, law and economics scholars are mostly concerned with regulatory competition as applied to corporations, banks, insurance companies, financial markets, competition (anti-trust) and the environment. (Salmon, 2006, 62) There are many objects of horizontal competitions but one of the most studied is taxation. There is a question that has to be asked. What are the effects of horizontal competition on welfare benefits, regulations associated with welfare and particularly in the domain of economic growth and mobility of individuals, goods and factors of firms. There is however an agreement that individuals and firms who pay taxes also greatly benefit from those paid taxes in many forms one of which is economic growth of certain individual, firm and self-government unit. But there is a problem concerning revenue collection, especially business transactions revenue collection.

On 31.12.2011. units of local self-government had 8,6 billion HRK of unpaid debts. With 5,4 billion HRK dominant are debts for business transactions revenue, and the other part of unpaid debt refers to debts for sales of nonfinancial asset. Biggest part of 5,4 billion HRK refers to administrative fees (about 60%) , followed by debt derived from revenue from own property (24%). When it comes to revenue collected from taxes, the debt is the smallest-only 16%. (Bajo, Primorac, 2013)

Problems concerning payment are related to weak cooperation regarding information exchange between Tax office and units of local self-government. Units of local self-government have empowered Tax office to collect revenue for them and Tax office charges provision in the amount of 5% of collected revenue. The problem is that Tax office delivers monthly reports about paid taxes but does not deliver information about tax payers who have

not paid their debt, issuing resolutions and about measures of collecting revenue. This is because Tax office is obliged to do so because of the Article 8 of Public Tax Law that concerns tax secrecy.

Furthermore data concerning public and local revenue are not as pubic an transparent as it should be. Units of local self-government do not inform citizens about efficiency of revenue collecting or its purpose and influence on economic development and improvement of life conditions. These information should be available to every citizen simply by publishing them on city or county web pages. Big part of the self-government units has their debt written off, which is not reasonable behaviour especially in these times of economic crisis. Also it has been established that 49% of 555 local self-government units did not impose all the revenue they could have by existing legal regulation and 29% of local self-government units did not undertake all the measures of ensuring the payment of existing debt. (Bajo, Primorac, 2013) The problem is more serious when we look at the big picture. Dealing with the fact that many of the self-government units have had the debt written off, they come to the state and demand help in the form of donations, financial support and grants and subventions.

7. CONCLUSION

Fiscal decentralisation has both economic and political effects. It can serve as one of the mechanisms to promote democratic institutions and expanding the quality, quantity and diversity of public services that suit the priorities of local populations. Fiscal decentralisation alone would not bring improved governance and ensure economic development at the local level without essential democratic institutions that responds to local priorities and preferences. Hence, fiscal decentralisation requires a favourable environment of democratic political system to operate as accountable, credible and efficient manner of mobilizing and utilizing fiscal resources, i.e. public revenue derived especially from local taxes. The autonomy of self-governments, from the conceptual point of view and particularly from the practical approach is the assessment of the economic opportunities, the amount and structure of resources, and the freedom of use of the resource. The actual operating conditions of each system depend not on the legal regulation, but instead on the the local economic circumstances of the self-government and their involvement of local economic development, furthermore on the economic and fiscal policy of the state.

The Croatian model, due to the important county and municipality taxes, is closer to the welfare and economic development models of self-governments, in which, besides the central dependence, a structure was established with more active self-governments providing notable services.

One of the most important things is to ensure fiscal autonomy of local and regional self-government units in executing expenditure and acquire revenue. Doing that they must ensure nearly equal possibilities for providing services to its residents and that is possible only by constant redefining aids of accommodation for decentralized functions. Also norms have to be determined in a way that current practice by which the central state regulates norms that concern units of local and regional self-government is avoided. That means that central state should not directly influence local and regional self-government units concerning their scope of authority.

Coming from the fact that degree of development of regional and local self-government units mostly differs, it is neccessary to find new models of financing by which we could satisfy local needs of citizens and achieve bogger equalisation of standards. In other words it is neccessary to achieve higher level of fiscal decentralisation, and that is possible only when local self-government unit has enough of own sources of financing for providing all public services within its scope of authority.

It is therefore important that the practice of fiscal decentralisation in Croatia be reoriented to improve the reach and quality of public services, to ensure fiscal discipline in the manner of not only paying but collecting revenue aswell, to cultivate democratic and effective institutions and in the process to contribute to address the fundamental economic, social and political development of the local self-government unit.

LITERATURE:

1. Bajo, A. and Primorac, T. (2013). *Neučinkovitost naplate prihoda lokalnih jedinica*, Aktualan osvrt br. 52, Institut za javne financije, Zagreb, Retrieved 15.3.2017. from http://www.ijf.hr/upload/files/file/osvrti/52.pdf
2. Ercsey, Z.,Jerković, E., Perić, R., Szilovicz, Sz. (2013). *The finances of local and regional self-government units* Pravo-regije-razvoj, DUNICOP, IPA Cross-border Cooperation Programme Hungary-Croatia, Pravni fakultet Osijek, Pravni fakultet Pečuh, pp. 221.-251.
3. Girma, A. (2013): *The political economy of Fiscal Federalism*, Ee-JRIF, Vol.5 No 1, Special Issue on the Ethiopian Economy, Ethiopia pp. 6.-32., Retrieved 22.3.2017. from http://africaim.com/wp-content/uploads/2013/07/ethiopian-economy.pdf
4. Jurlina Alibegović, D., (2003). *Financiranje lokalne samouprave*, u Ott, Katarina, Bajo, Anto, i Pitarević, Mihaela, ured., Fiskalna decentralizacija u Hrvatskoj. Radovi s konferencije with Introductory Chapter in English (Fiscal Decentralization in Croatia. Papers from the Conference with Introductory Chapter in English). FDI Proceedings. November 14-15, 2003, Zagreb: Institut za javne financije, Zagreb i The Fiscal Decentralization Initiative for Central and Eastern Europe, Budapest, str. 92-107.
5. Musgrave, Richard. (1983). *Who Should Tax, Where, What?* in Charles McLure, Jr. (ed.) Tax Assignment in Federal Countries, Canberra: Center for Research on Federal Financial Relations, ANU.
6.Salmon, P. (2006). *Horizontal competition among government*, Handbook of Fiscal Federalism, Edited by Ehtisham Ahmad and Giorgio Brosio, Cheltenham, UK, Northampton, MA, USA, pp. 61-86., Retrieved 19.3.2017. from https://books.google.hr/books?hl=hr&lr=&id=zT3ijSfypKkC&oi=fnd&pg=PR2&dq=fiscal+federalism+in+theory+and+practice&ots=RTTWU6Lpbq&sig=VWnHfMOjy_6AL0RFqUrzQ-WhlfA&redir_esc=y#v=onepage&q=fiscal%20federalism%20in%20theory%20and%20practice&f=false
7. Srb, V. and Perić, R. (2004). *Javne financije*-knjiga I [Public Finance – Volume 1](2004) University J. J. Stossmayera, Faculty of Law in Osijek, ISBN: 953-6072-26-2, Osijek
8. Šimović, J., Arbutina, H., Mijatović, N., Rogić-Lugarić T. and Cindori, S. (2008). *Financijsko pravo i financijska znanost*, Narodne novine d.d., ISBN: 978-953-234-107-2, Zagreb
9. Šimović, J., Arbutina, H., Mijatović, N., Rogić-Lugarić T. and Cindori, S. (2010). *Hrvatski fiskalni sustav*, Narodne novine d.d., ISBN: 978-953-234-146-1, Zagreb
10. *Yearly Report of Ministry of Finances for the year of 2014.*, Retrieved 20.3.2017. from http://www.mfin.hr/adminmax/docs/Godisnjak%202014..pdf

Pieces of legislation:

11. *European Charter of Local Self-government*, Strasbourg, 15.X.1985
12. *Income Tax Law*, Official Gazette, 177/04, 73/08, 80/10, 114/11, 22/12, 144/12, 43/2013, 120/2013, 125/2013, 148/2013, 83/2014, 143/2014, 136/2015, 115/2016
13. *Law on Financing of Local and Regional Self-Government Units*, Official Gazette 117/1993, 92/1994, 69/1997, 33/2000, 73/2000, 127/2000, 59/2001, 107/2001, 117/2001, 150/2002, 147/2003, 132/2006, 26/2007, 73/2008, 25/2012, 147/2014, 100/2015, 115/2016

14. *Law on Local and Regional Self-Government*, Official Gazette 33/01, 60/01, 106/03, 129/05, 109/07, 125/08, 144/12, 19/13, 137/15
15. *Law on Local Taxes*, Official Gazette 115/16
16. *Public Tax Law*, Official Gazette 147/08, 18/11, 78/12, 136/12, 73/13, 26/2015, 44/2016, 115/2016
17. *Tax on Sales of Real Estate*, Official Gazette 69/97, 26/00, 127/00, 153/02, 22/11, 143/14, 115/16

TOURISM LEGISLATION AND POLICY: REVIEW OF TOURISM LAW IN SELECTED BALKAN COUNTRIES

Dejan Metodijeski
Goce Delcev University, Stip, Macedonia
dejan.metodijeski@ugd.edu.mk

Nako Taskov
Goce Delcev University, Stip, Macedonia
nako.taskov@ugd.edu.mk

Elizabeta Mitreva
Goce Delcev University, Stip, Macedonia
elizabeta.mitreva@ugd.edu.mk

Oliver Filiposki
Goce Delcev University, Stip, Macedonia
oliver.filiposki@ugd.edu.mk

Jasmina Andreeva
St.Kliment Ohridski University, Sofia, Bulgaria
sofialaw@abv.bg

ABSTRACT

Despite political turmoil and natural disasters in various parts of the world, tourism is one of the successful stories of present time and has shown constant economic grown in past few decades. Tourism has significant social and economic benefits for different countries, and tourism related legislation and policy created by various governments is one of the primary factors for the existence and development of tourism related activities. The subject of this paper is tourism legislation and policy of selected Balkan countries, as seen through the prism of tourism law in Croatia, Serbia, Macedonia and Bulgaria. Criteria for choosing this countries are membership in European Union and see border of Croatia and Bulgaria on the one hand, and continenatal territory and candidate for accession to the European Union from Macedonia and Serbia on the other. The paper provides basic data for the selected Balkan countries such as: territory characteristics, population, number of international tourists, tourism law and existence of a National Tourism Organization. Table showing government bodies responsible for tourism, national tourism development strategies as well as tourism related legislation is used to prepare a comparative analysis of selected countries. For the purpose of paper we use research methodology and secondary data sources by consulting official tourism laws of selected countires. An analysis and review of tourism laws has been made, based on systematical evaluation of their actual content. The paper concluding remarks are regarding the structure, differences and similarities of the tourism laws and how the legislation determine prospects and directions of tourism development in the Balkan countries.

Keywords: *Balkan countries, tourism legislation, tourism policy*

1. INTRODUCTION

Tourism is a unique phenomenon present in all countries around the world and has constant tendency of increasing its growth on a global level. There is no country in the world that does not develop some type of tourism or a country where citizens are not involved in tourist

movement outside of their permanent place of residence for various reasons such as business, pleasure, sports and recreation, religion or other reasons. According to the United Nations World Tourism Organization (UNWTO, 2016), international tourists arrival in 2015 has reached 1.184 million. Tourists expenditure reached to 1.400 billion US dollars, and the tourism industry participated with 10% of the global GPD (gross domestic product). Every eleventh employed person in the world is employed within the tourism industry. Tourism will maintain its continuous and positive level of development from the past 60 years in the coming years. Forecasts are moving in a direction that the European continent, in which the selected Balkan countries are located, within the next years, will be the most evident source of tourist demand and the development of international tourism in the world.
Balkan Peninsula is located in Southeastern Europe and covers the territory of about 600,000 square kilometers with a population of around 60 million people. The name of Balkan Peninsula is of Turkish origin, or rather from the Turkish word "balkan", which means "mountain with forest" (Griffiths, Kryštufek, Reed 2004, p.14). Geographical boundaries of the Balkan Peninsula vary according to the parameters that are taken into account, but for the purposes of this paper the boundaries are the water surfaces that surround the peninsula such as the Black Sea, Aegean Sea, Adriatic Sea and the rivers Sava and Danube.

Table 1: Review of basic tourism parameters in selected Balkan countries (source: UNWTO Tourism highlights, 2016 Edition. Madrid: UNWTO and UNESCO World heritage list)

Country	Population (000)	Area in km² (000)	Tourist arrivals (000) in 2015	UNESCO World heritage list properties	Value added tax on tourism in %	Tourist tax (in Euro)
Croatia	4,496	56,594	12,683	8	13	0,26-0,92
Serbia	7,186	88,361	1,132	5	10	1,26
Macedonia	2,054	25,713	486	1	5	0,66
Bulgaria	7,517	110,994	7,311	9	9	0,10-1,53

Table 1 shows that we choose several criteria for comparing basic tourism parameters in selected Balkan countries Croatia, Serbia, Macedonia and Bulgaria as population, area in km², tourist arrivals, UNESCO World heritage list properties, Value added tax on tourism and tourist tax. Criteria for choosing this four countries are membership in European Union and see border of Croatia and Bulgaria on the one hand, and continenatal territory and candidate for accession to the European Union from Macedonia and Serbia on the other. According to the number of population and area of the territory of the Balkan Peninsula, from selected countries Bulgaria is the largest country where the smallest country is Macedonia. According to the arrivals of tourists visiting the selected Balkan countries, most of them have visited Croatia and least tourists has visited Macedonia. The number of items included in the World Heritage List by UNESCO in the world is 1052, including 814 cultural, 203 natural and 35 mixed, situated in the territories of 165 countries. Most of the items included in the list are located in Bulgaria - nine, followed by Croatia with eight, Serbia with five and one is located in Macedonia - Natural and Cultural Heritage of the Ohrid region, adopted in 1979. Data concernig Value added tax (VAT) on tourism shows that Croatia has the highest VAT related to tourism services (13%), and Macedonia has the smallest VAT of 5%. Regarding the tourist tax for tourist stay, it varies in different countries. In Macedonia and Serbia there is a fixed fee, and in Croatia and Bulgaria it varies depending on the municipalities and regions it is performed.

2. THEORETICAL AND METHODOLOGICAL FRAMEWORK

Tourism has significant social and economic benefits and many countries encourage the development of tourism through different forms of support. At the national level the development of tourism is falling under the Ministries and National tourism organizations. These institutions are engaged in carrying out activities such as controlling the tourist activities with tourism and hospitality related law and regulations; gathering information about the tourism sector; preparing a national tourism development strategies; tourist promotion and more. National tourism organizations are present in more than 100 countries. UNWTO has audited the budget of 109 such organizations and it has defined the agencies and its subsidiaries as follows (Jeffries 2001, p.10):

a) National Agency for tourism is defined as: central administrative body with administrative responsibility for tourism at the highest level i.e. central management authority with a power for direct intervention in the tourism sector; and all administrative authorities who have the power to make interventions in the tourism sector.

b) Other governmental or administrative bodies of lower rank. An example is the National Tourism Organization, which is defined as: an autonomous governmental body, with semi-public or private status, established or recognized by the state as an authority having jurisdiction at the national level to promote, and in some cases marketing the tourism industry.

The term "tourism policy" is representing the conscious activity of the state, or society in the field of tourism (Ackovski & Ackovska 2003, p.150-165). Primary task of this policy is to undertake measures and activities that will be of crucial importance for the initiation of relevant factors responsible for tourism development in order to increase the tourist trade and consumption and to improve its structure and quality. In more specific terms, tourism policy fulfills the following functions (Goeldner & Ritchie 2009, p.): It defines the rules of the game - the terms under which tourism operators must function; It sets out activities and behaviors that are acceptable for visitors; It provides a common direction and guidance for all tourism stakeholders within a destination; It facilitates consensus around specific strategies and objectives for a given destination; It provides a framework for public/private discussions on the role and contributions of the tourism sector to the economy and to society in general; and It allows tourism to interface more effectively with other sectors of the economy.

Tourism policy has direct and indirect holders or executors. Direct holders and operators of tourism policy are (Ackovski & Ackovska 2003, p.150-165): representatives of government bodies at all levels (assemblies, parliaments, individual councils, institutions, commissions, etc.); and the executive administration (government) at all levels (secretaries, tourism ministries, committees for Hospitality and Tourism, the main offices of hospitality and tourism at national, regional, municipal, city and a similar level). Indirect holders and executors of tourism policy are: special bodies outside the public administration (municipalities and chambers of special business associations); social organizations in the field of hospitality and tourism (tourism associations at all levels, tourist bureaus); local communities; and gathering and other commercial and non-commercial organizations in the tourism industry that directly or indirectly participate in meeting the tourist needs.

For the realization of the objectives of tourism policy various measures (instruments and resources) are applied. In general, all instruments of tourism policy can be divided into four groups (Ackovski & Ackovska 2003, p.150-165): legal regulations which mainly include: constitutional provisions, laws, bans, permits, decisions, orders, etc.; administrative instruments which mainly include: taxes, duties, fees, contributions, loans and other public revenues and public subsidies (compensation, contributions, premiums, guarantees, regression, etc.); economic instruments mainly including: plans, programs, resolutions, funds, loans, bonds, rates and prices, etc.; and contracts and agreements.

The purpose of this paper is to make review of tourism policy and legislation in selected Balkan countries. In the interest of the paper, we use secondary data sources by consulting relevant literature on the subject of tourism policy and legislative and the Internet. A literature review shows that there is existing body of literature concerning tourism and travel law (Krstanoski, 2005; Barth, Hayes, 2006; Cournoyer, Marshall, Morris, 2007; Singh, 2008). Although the purpose of the paper does include comparative law in a small part, it should be noted that the volume of literature in this area is extensive (Gutteridge, 1946; Cruz, 1999; Reimann, Zimmermann, 2008; Smits, 2012; Clark, 2012; Mathias, 2014), but lack of research related to analysis of tourism law is noted. Using Internet sources we also collected data such as tourism strategies and tourism law that have been analyzed later. The main method used in this comparative research is content analysis (Hall, Valentin 2005, p.191). Content analysis is an observational research method that is used to systematically evaluate the actual content of the tourism policies and tourism law of four Balkan countries: Croatia, Serbia, Macedonia and Bulgaria.

3. TOURISM POLICY, NATIONAL TOURISM DEVELOPMENT STRATEGIES AND TOURISM LAW OF SELECTED BALKAN COUNTRIES

Tourism sector in the various Balkan states falls under the jurisdiction of different ministries. For example, in Croatia and Bulgaria as the most developed tourist countries there are separate Ministry of tourism. In Serbia, tourism policy is created in ministry where the tourism industry is combined with other sectors trade and telecommunications. In Macedonia, tourism is managed by the Department of Tourism and hospitality within the Ministry of economy.

Table 2: Government bodies responsible for tourism policy development of Balkan countries (source: Official web pages of selected institutions)

Country	Government body responsible for tourism policy development (official web page)	National tourism organization (NTO)/agency (official web page)	NTO Annual marketing budget (Euro 000)
Croatia	Ministry of tourism (mint.hr)	Tourism organization of Croatia (croatia.hr)	43.052
Serbia	Ministry of trade, tourism and telecommunications (mtt.gov.rs)	Tourism organization of Serbia (srbija.travel)	3.834
Macedonia	Ministry of economy, Department of tourism and (hospitality economy.gov.mk)	Agency for promotion and support of tourism of Macedonia (tourismmacedonia.gov.mk)	1.032
Bulgaria	Ministry of tourism (tourism.government.bg)	Tourism organization of Bulgaria (bulgariatravel.org)	6.684

It should be noted that selected Balkan countries have established national tourism organizations, for example the Tourism organization of Serbia, Croatia and Bulgaria or government agencies for tourism, as exemplified by the Agency for promotion and support of tourism of Macedonia. These bodies have prepared official websites and also perform the function of promoting the tourism potential of a given country at international level. Highest annual marketing budget for promotion belongs to the National tourist association of Croatia

(a little bit more than 43 million Euro), and the lowest one belongs to the Agency for support and promotion of tourism of Macedonia (a little bit more than 1 million Euro).
One of the instruments of tourism policy is the development of strategies for tourism development. Managing the development of individual companies, industries or sectors at national, regional and destination level, for which often are produced special programs and development solutions that are called strategies (Budinoski 2009, p.22). Tourism development strategy includes system of management solutions which determine the prospects for development forms and methods of its action, the allocation of resources for the purpose of achieving certain goals. In Table 3, an overview of the Balkan countries is presented, from which we can observe that all countries have developed and adopted national strategies for the development of tourism. Tourism development strategies are usually made for a period of several years.

Table 3: Review of National tourism development strategies and types of tourism in selected Balkan countries (source: National tourism development strategies of the selected countries)

Country	National tourism development strategy	Types of tourism included in tourism development strategy
Croatia	Tourism development strategy in Republic of Croatia until 2020	Sun and sea; Nautical tourism; Business tourism; Bike tourism; Gastronomy and enology; Rural and mountain tourism; Cultural tourism; Golf tourism; Sport tourism; Ecotourism
Serbia	Tourism development strategy in Republic of Serbia 2015-2025	MICE and business tourism; City Breaks; Mountain and lake tourism; Spa and wellness; Touring; Cruise tourism; Special interest tourism; Transit tourism; Event tourism; Rural tourism
Macedonia	Tourism development strategy in Republic of Macedonia 2016–2020	Lake tourism; Urban tourism; Mountain tourism; Spa tourism; Wine tourism; National parks; Cultural tourism
Bulgaria	Strategy for sustainable development of tourism in Bulgaria 2014–2030	Sea tourism; Mountain and ski tourism; Spa and wellness tourism; Cultural tourism; Ecotourism; Wine tourism; Golf tourism; Event tourism; Hunting tourism

In all strategies presented, the mission and vision of the level and the development of tourism in the future is included. Most of the strategies are made by ministries and experts in the field of tourism as well as educational institutions and NGOs. Strategy for tourism development in Macedonia is the latest, prepared in 2016, and the strategy for tourism development of Bulgaria is the longest i.e. until 2030. Common types of tourism, through which selected Balkan countries, with its national strategies for the development of tourism, dedicate special importance are the following: spa tourism, mountain tourism, business tourism, wine tourism, urban tourism and rural tourism. Concerning tourism law, the three countries Croatia, Serbia and Macedonia share a common legal history until 1991, after that stage the countries become independent and modified its tourism law based on the own suitable model and according to the level of tourism related activities and development. It should be noted that Bulgaria was also until 1991 a socialist country with a legal system as were the other three considered countries. In Bulgaria and Serbia there are laws for tourism, and in Croatia and Macedonia the laws are connected with the tourist services or tourist activity. Namely, in Croatia and Macedonia there are additional laws related to tourism. In Croatia, there are the following laws: Law on hospitality 85/2015; Law on tourism communities and promotion of

Croatian tourism 152/2008; Law on membership fee in tourist communities 152/2008; Law on temporary residence fee 152/2008, Law on tourist inspection 19/2014, Law on tourist and other construction land unassessed in the procedure of privatization 92/2010. In Macedonia the laws are: Law on hospitality 62/2004; Law on the establishment of the Agency for promotion and support of tourism of the Republic of Macedonia 103/2008; Law on temporary residence fee 19/1996; Law on tourism development zones 141/2012; Law on Auo Camps 13/2013.

Table 4: Review of tourism law in selected Balkan countries (source: Official web pages of selected government bodies responsible for tourism)

Country	Tourism law	Content of tourism law and main chapters
Croatia	Law on tourism services. Official Gazette of the Republic of Croatia №68/2007	I Basic provisions; II Services of tourist agencies; III Services of tourist guide, tourist escort, tourist animator and a tourist representative; IV Tourist services in nautical tourism; V Tourism services in the village household or family agricultural household; VI Travel services for other types of tourist offer; VII Other tourist services; VIII Sporting-recreational and adventure services; IX Supervision; X Penal provisions; XI Transitional and final provisions (a total of 81 articles)
Serbia	Law on Tourism. Official Gazette of the Republic of Serbia №36/2009	I Basic provisions; II Planning and development of tourism; III Tourist organizations for promotion of tourism; IV Travel agencies; V Hospitality activity; VI Nautical activity; VII Hunting-tourist activity; VIII Services in tourism; IX Fees and penalties in the tourism industry; X Registers in tourism; XI Supervision; XII Penal provisions; XIII Transitional and final provisions (a total of 137 articles)
Macedonia	Law on Tourism activity. Official Gazette of the Republic of Macedonia №62/2004	I Basic provisions; II Suppliers of tourist activity; III. Conditions and manner of performing tourist activity; IV Supervision; V Penal provisions; VI Transitional and final provisions (a total of 80 articles)
Bulgaria	Law on Tourism. Official Gazette of the Republic of Bulgaria №30/2013	I Basic provisions; II State policy and bodies for tourism management; III Tourist regions; IV Tourist associations; V Tourist information centers. National network of tourist information centers; VI Financial assistance for the development of tourism; VII Tour-operating and tourist agency activities; VIII Hotel and Restaurant activities; IX Conditions and the order for the provision of spa and wellness services. Certification of medical spa, spa, wellness and thalassotherapy centers; X Electronic Document submitting; XI Issue of duplicate assurances and certificates; XII Travel guides, mountain guides and ski instructors; XIII Runways for skiing. Types. Use, maintenance and security. Travel services. XIV Beaches. Types. Use and security; XV National tourist registry. Single system for tourist information; XVI Supervision; XVII Penal provisions; XVIII Transitional and final provisions (a total of 231 articles)

Table 4 shows that in Bulgaria and Serbia there are laws on tourism, and in Croatia and Macedonia, the laws are related to tourism services and activities. The most complex is the law on tourism of Bulgaria with 18 chapters and 231 articles, while the law on tourist activity in Macedonia is the simplest, containing six chapters and 40 articles. In all the countries, in addition to the laws on tourism, there is a great number of books on rules and regulations associated with the regulation of the tourism industry. The research has shown, that the mentioned laws in all four countries from the moment of the passing until today, have undergone numerous amendments. It shows that the states care not only about adoption, but also about re-assessment of the proposed legal solutions, as well as about possible amendments to the tourist laws aiming for improvement of the regulation for the interests of all interested parties.

4. CONCLUSION

The aim of this paper was to make a review of the tourism policy and legislative in selected Balkan countries manifested through the work of the authorities, most often ministries, whose responsibilities include tourism development, establishment of national tourist organizations, development of a National strategy for tourism development and tourism law. Selected Balkan countries have adequate natural and anthropogenic resources for tourism development and follow modern trends in the international tourism market. In order, for the sustainable tourism industry in the future, it requires an effective policy and legislative to be establish nowadays. The creators of tourism policy and strategies should be able to identify the tourism trends and propose adequate mechanisms aimed at development of high quality tourism products and services. The research carried out for the purposes of this paper, performed by comparative method has shown, that the selected Balkan countries have paid serious attention to the tourism activities. This conclusion is confirmed by the fact that the four countries that were the subject of the research (Croatia, Serbia, Macedonia and Bulgaria) have appropriate state institutions covering the tourism sector through its ministries and directly participating in the creation of the tourism policy and legislation. In the four countries there are National organizations that care about tourism promotion and have adopted Strategies for development of tourism that keep the pace with the modern travel needs of international tourists. The four countries have the appropriate laws and regulations related to tourism that for the purpose of the needs of the stakeholders and of improvement from the moment of their adoption have undergone numerous ammendments.

ACKNOWLEDGEMENT: *This study is a part of the research project funded by the Goce Delcev University - Stip, Macedonia (Ref. №1402-542/1).*

LITERATURE:

1. Ackovski, N, Ackovska, M. (2003). *Economics and organisation of hospitality*. Ohrid: University St.Kliment Ohridski.
2. Barth, S, Hayes, D.K. (2006). *Hospitality law: Managing legal issues in the hospitality industry*. New Jersey: John Wiley & Sons.
3. Budinoski, M. (2009). *Tourism development and planning*. Skopje: University of tourism and management.
4. Clark, D.S. (2012). *Comparative Law and Society*. Cheltenham; Northampton: Edwar Elgar.
5. Cournoyer, N., Marshall, A., Morris, K. (2007). *Hotel, restaurant and travel law: A preventive approach* (7th edition). Clifton Park: Thomson Delmar Publishers.
6. Cruz, P. (1999). *Comparative law in a changing world* (Second edition). London; Sydney: Cavendish Publishing Limited.
7. Goeldner, C, Ritchie, B. (2009). *Tourism: principles, practices, philosophies* (9th edition). New Jersey: John Wiley & Sons.
8. Gutteridge, H.C. (1946). *Comparative Law: An Introduction to the comparative method of legal study and research*. Cambridge: Cambridge University Press.
9. Hall, M, Valentin, A. (2005). Content analysis. In Ritchie, B, Burns, P, Palmer, C. *Tourism research methods: Integrating theory with practice* (p.191). Oxfordshire: CAB International.
10. Jeffries, D. (2001). *Governments and tourism*. Oxford: Butterworth-Heinemann.
11. Krstanoski, M. (2005). *Tourism law*. Bitola: University St.Kliment Ohridski.
12. Law on tourism activity. (2004). *Law on tourism activity*, Official Gazette of the Republic of Macedonia number 62. Retrieved 02.04.2017 from http://www.slvesnik.com.mk/Issues/0DBE51B8AAD60144B46F27D7463966D4.pdf

13. Law on tourism services. (2007). *Law on tourism services*, Official Gazette of the Republic of Croatia number 68. Retrieved 02.05.2017 from http://www.mint.hr/UserDocsImages/150113_ZoPUuT.pdf
14. Mathias, S. (2014). *Comparative Law*. Cambridge: Cambridge University Press.
15. Metodijeski, D, Temelkov, Z. (2014). Tourism policy of Balkan countries: review of national tourism development strategies. *UTMS Journal of Economics*, 2014 5(2), 231-239. Retrieved 05.04.2017 from http://www.utmsjoe.mk/files/Vol.%205%20No.%202/2-10_Medodijeski-Temelkov2(1).pdf
16. Reed, J, Kryštufek, B, Eastwood, W. (2004). The phisical geography of the Balkans and nomenclature of place names. In Griffiths, H, Kryštufek, B, Reed, J. *Balkan biodiversity: Pattern and process in the European hotspot* (p.14). Dordrecht: Kluwer Academic Publishers.
17. Reimann, M, Zimmermann, R. (2008). *The Oxford Handbook of Comparative Law*. Oxford: Oxford University Press.
18. Singh, L.K. (2008). *Trends in travel, tourism and law*. Delhi: ISHA Books.
19. Smits, J.M. (2012). *Elgar Encyclopedia of Comparative Law* (Second Edition). Cheltenham; Northampton: Edwar Elgar.
20. Strategy for sustainable development of tourism in Bulgaria. (2016). *Strategy for sustainable development of tourism in Bulgaria*. Retrieved 02.04.2017 from http://www.tourism.government.bg/bg/kategorii/strategicheski-dokumenti/nacionalna-strategiya-za-ustoychivo-razvitie-na-turizma-v
21. Tourism development strategy in Republic of Croatia. (2013). *Tourism development strategy in Republic of Croatia*. Retrieved 02.04.2017 from http://www.mint.hr/UserDocsImages/Strategija-turizam-2020-editfinal.pdf
22. Tourism development strategy in Republic of Macedonia. (2016). *Tourism development strategy in Republic of Macedonia*. Retrieved 02.04.2017 from http://www.economy.gov.mk/Upload/Documents/BER_Tourism%20Strategy%20Macedonia_DRAFT_16%2001%2021_MK%20(1)%20(3).pdf
23. Tourism development strategy in Republic of Serbia. (2016). *Tourism development strategy in Republic of Serbia*. Retrieved 02.04.2017 from http://mtt.gov.rs/download/3/strategija.pdf
24. Tourism law. (2009). *Tourism law*, Official Gazette of the Republic of Serbia number 36. Retrieved 02.04.2017 from http://mtt.gov.rs/download/1(2)/ZAKON%20O%20TURIZMU.pdf
25. Tourism law. (2013). *Tourism law*, Official Gazette of the Republic of Bulgaria number 30. Retrieved 02.04.2017 from http://www.tourism.government.bg/sites/tourism.government.bg/files/documents/2016-10/zt.pdf
26. *United Nations Educational, Scientific and Cultural Organization World heritage list*. (2017). Retrieved 01.04.2017 from http://whc.unesco.org/en/list/

ECONOMIC AND LEGAL EFFECTS OF LABOUR MARKET FLEXIBILITY

Dimitrijevic Vladimir
PE Post of Serbia, Belgrade, Serbia
vdimitrijevic@jp.ptt.rs

Vukosavljevic Danijela
Faculty of Management, Sremski Karlovci, Serbia
dr.danijela.vukosavljevic@gmail.com

Vukosavljevic Dejan
Faculty of Management, Sremski Karlovci, Serbia
vukosavljevic.dejan@gmail.com

ABSTRACT

Flexible work is therefore an ambiguous concept in reaching the business success and advantages in an enormous rising competitive environment, and at the same time, flexible work might be criticized for its negative effects on workers and society, what was the reason to research the experience from small Balkan countries economies where labor flexibility has not been very good accepted. The methods used are desk research and field research of 98 employers and 215 workers provided in 2016 in Croatia, Montenegro, Macedonia and Serbia on the economic and legal aspects of labor flexibility. In this paper is presented employers experience in flexible working. Key results show that in western Balkan countries legislative on flexible work patterns is not completed, as well not transparent to EU best practices, but beside that a great number of employers had the experience in flexible work arrangements: Temporary casual employment have used 66% of respondents mostly self-employed and small companies; Working during the weekend 10% of the respondents; Working at/from home 12% of legal entities had that experience; Seasonal work- 31% have used this form of hiring workers in 2016; Temporary employment has been mostly used by agencies and self-employed individuals, 83% of them, by 80% of large enterprises, 65% of craft shops, 47% of small enterprises and 30% of medium-sized enterprises; Help at home -12% of respondents have used this work pattern and . Hiring two people for one position only 11% of respondents did this in the previous period, mostly used by large enterprises. The desk research results suggest that the major changes currently taking place in relation to working time relate to its arrangement rather than its duration. The long-term decline in the number of hours worked has also slowed, but in some Balkan countries working hours may even have begun to increase. In the eyes of trade unions and workers, increased international competition in goods and service markets has been having negative implications on labour conditions and, in this respect, upon the number of hours that employees have to work and on the schedules that they have to fulfill. Candidate countries from Balkan might be facing economic pressures to reform the organisation of work in order to realise business targets, but much differ in a regulatory, institutional, economic, or social perspective. This paper contribution is also in supporting transparency in legal aspects of flexible working its competition and transfer of good practices to the candidate countries.

Keywords: *economic impact, labour market flexibility, legislation, flexible working patterns,*

1. INTRODUCTION

Changes in the economic and social environment that have induced changes in working time have not been met passively. Workers and trade unions as their representatives, but also governments, individually and collectively have sought to develop responses. It is in this context that the concept of "flexible security" (or flexicurity) has achieved prominence. At the same time this has meant recognition that new work patterns might be necessary but not with negative impact to health, disruptive to place burdens intolerable burdens, to social life, or upon those who have domestic demands as well as a need to generate income from paid work. In western Balkan countries, these changes made a lot of negative effects to trade union organising in the enterprises within foreign capital, as well as in the labor market with partial regulations, decreasing the workers' rights. Over the long-term Europe has seen a reduction in individual's working hours. With an increase in the proportion of the population engaged in formal employment, the aggregate volume of hours available to the labour market has increased. Looking across last decade, the European Working Conditions Survey (EWCS) shows that, from the employees' perspective: working hours have been in decline mainly due to the decline in long hours working amongst men and the increase in part-time working, the decrease in working hours has slowed over the past five years mainly due to the accession of new member states, the percentage of the workforce working atypical work schedules has remained stable over the past five years, the pace of work has intensified over recent years. It also reveals that around 80 per cent of employees are able to fit their working hours around their social commitments – this tends to be lower in the eastern and southern candidate and member states.

The phenomenon of flexibility in the workplace and labour market has been a subject of interest for European economic and social actors for the last ten years, as well as in western Balkan countries. This paper aims to state the trends of employment based on the principles of flexible forms of work, in addition to temporary work agencies, the practice of European countries and the development of the Balkans. The possibilities of faster integration into the labour market and economic perspectives is being illuminated, whereby data from national reports has been used, in addition to data from the European Foundation for the improvement of living and working conditions, as well as field research conducted by employers in Serbia in 2016 on their previous experience in flexible working patterns usage.

2. LITERATURE BACKGROUND

Flexible work arrangements are based on Atkinson's (1984) groundbreaking flexible firm model. These patterns enable an organization to adapt its workforce to changes in the working environment. The flexible patterns of work are non-standard working conditions (e.g. temporary or contract workers). Employers are enabled to use flexibility to better adaptation to changing requirements of customers or production environment demands by allocating the work force, on the other side, the employee perspective flexibility means options to choose, time, duration of work achieved by contractual, temporal and spatial flexibility (overtime, on-call work, flextime, and telecommuting). However, statements (Pollert, 1991, p. 9) that follow the assumption that rigidity is dysfunctional; flexibility, functional' fall short. According to Sennet (1998) from a systemic perspective flexibility may lead to constraints for the employee. Researchers (Höge, 2011; Hornung et al., 2008; Reilly, 1998) make the difference between capacity-oriented flexibility and employee-oriented flexibility or flexibility opportunities and flexibility demands to capture the potential positive or negative effects of flexibility on employees and organizations. Johnsson (2006) makes a distinction between being flexible and having flexibility, and between explorative and exploitative learning (Raisch et al., 2009).

The duration of working time simply refers to how long people work. The organisation of working time refers to when people work, how often they work, the flexibility they have with respect to start and finish times, and the reference period over which average hours are calculated. In very many respects the discussion of the organisation of working time has become dominated by the issue of flexibility: for the individual employee and for the employer. Commonly, the organisation of working time has concerned the following:

- **part-time work** (officially classified as 30 hours or fewer per week);
- **overtime work** – the arrangements in place for working overtime (its definition, whether it is voluntary, and pay rates);
- **non-standard working times** (including shift work, night work, working Saturdays and Sundays);
- **flexible working patterns connected with time**, include:
  - ✓ **annualized hours** – where employees are expected to work a given number of hours over a certain period, a year, number of months, but where hours in any one week can be varied to help meet the demand for labour;
  - ✓ **flextime** – where employees are expected to work so many hours each week (or some other reference period) but are allowed to start and finish each day within a defined time frame;
  - ✓ **contracts with term-time** – working only during school terms and take leave during school holidays;
  - ✓ **compressed working weeks** – where employees work the hours associated with a standard working week but work these hours over fewer days than usual (*e.g.* five days' work carried out over four days).

Temporary employment often seems to relate much more too hiring and firing policies than to the optimal allocation of labour to the production process at a given point in time. Based on the work of Duncan (1976) researchers assume that organizations must implement dual structures in order to facilitate long-term success. More precisely, this ambidextrous situation holds also true for the field of flexible work. The theory path-dependency and path-breaking (Sydow et al., 2009) considers that By simultaneously combining flexibility, innovation and new knowledge parallel with the exploiting existing competencies, companies could be more capable to adapt to competitive environmental dynamics. follows a similar logic

From the economic literature sources (Lai et al., 2008) is seen that the issues researched regard the way firms can realize a flexible workforce (Mayne et al., 1996) supposing that flexible work has economic benefits (Wright & Snell, 1998) and is therefore a valid goal for firms. There also can be found criticism within the discourse on flexible work concerning the negative side-effects of flexible work. Researchers with sociological backgrounds have extensively discussed job insecurity (Kozica et al., 2012) which has increased in parallel with the increase in flexible working practices (Beck, 2000; Cooper, 2008; Doogan, 2001; Hesseling & van Vuuren, 1999; Lambert, 2008). From the literature it can be learned that it have to be adopted a differentiated perspective when analyzing the effects of flexibility, as there is no there only positive but also negative effects of flexibility.

3. EUROPEAN UNION ECONOMIC AND LEGAL ACTIVITIES

The employment rate based on flexible forms of work, working hours and fixed-term contracts is rising. EU countries have defined these forms of employment with special laws, specifically laws relating to temporary work agencies, rounding out legislation in the labour

market. Temporary work agencies have been growing rapidly in recent years, as a part of the general development of atypical -flexible forms of work in Europe and other developed countries around the world. According to the data of the EU (European Working Conditions Surveys: 1991-2005) conditions in Europe are in accordance with the changes in the last years, with the main trends being:

- Constantly decreasing the average number of weekly work hours,
- An increase of the percentage of part-time working hours,
- Most workers still have fixed work schedules, although the number of workers with flexible work schedules is constantly increasing,
- For most workers their place of work directly depends on the demands of the consumer, which reflects the increasing domination of the service sector,
- The intensity of work is increasing in the EU,
- Workplace autonomy in the EU is declining although is relatively high,
- The percentage of people using IT technologies is rapidly rising, it was 31% 15 years ago, rising to 47% in 2015. At the same time, a considerable number of workers never uses computers in the workplace (44%), and
- One out of four workers believes that their health care and social security are at risk because of their jobs. When it comes to new EU Member States, this figure rises to 40%.

Temporary work agencies represent the fastest growing form of atypical employment in the EU since 1999. This is substantiated by data (according to CIETT, in the year 2000, 2.2 million people worked in this sector in the EU) showing the increase in the number of these agencies, which in the majority of countries has doubled, while increasing fivefold in Denmark, Spain, Italy and Sweden. About six million people worked in these agencies in 2000, while this figure rose to 30 million in 2005. In 1995, the European Commission organised consultations for social partners on issues regarding flexible work hours and employee security, singling out some of the basic forms of atypical employment. Part-time employment, work hours with a specific duration and employment via temporary work agencies fall into this category. Two basic agreements were concluded as new EU directives, one in relation to part-time employment in 1987, and one in relation to fixed-term employment in 1999. The negotiations concerning employment via temporary work agencies were intensified in the year 2000.

Legally regulating temporary employment on the level of the European continent was a contentious process spanning a period of 20 years, from the moment the Commission proposed a directive for the first time in this field in 1982. The main focus was on how to better balance creativity and flexibility of employment on the one hand, meanwhile protecting and guaranteeing safety to employees on the other hand. The debate on temporary employment is most critical in relation to temporary work agencies. The question of the equal treatment of temporary and permanent employees is a complex issue because of the nature of the contract, which causes difficulties that need to be solved in the same way for both sides. European social partners such as UNICE, CEEP and ETUC signed a cross-sector contract for a specific period of time, which helped the directive of 2001. The EU Committee for the sectoral social dialogue finally negotiated and passed a joint declaration regarding European directive Objects concerning temporary work agencies in 2001. In 2002, the Commission took initiative and proposed a draft of the directive for temporary employment agencies, approving the principle of non-discrimination between temporary agency workers and

permanent employees in user companies, subordinated with certain constraints and exemptions. The first steps of legally defining temporary work agencies in EU15 were seen from 1960-1970 by the more developed economies and countries of Northern Europe. There is a difference between these countries when it comes to the major sectors and occupations that use temporary work agencies, but they are mainly used for: production, services, and for combinations that include both sectors. Many of these jobs require technically qualified and professional workers, although a large part of the workers in these agencies, regardless of their occupation, are used for less skilled work. This is not surprising because companies often use this kind of work in the internal market of the workforce for developmental reasons with less sales barriers. On the supply side, specific groups of the workforce who find temporary work appealing as a means of gaining work experience and useful skills include: students, women who want to start working again after maternity and family leave, persons with disabilities and those who do not want to or cannot compete with the high demands of the labour market. There is also a difference between countries regarding how long workers from temporary work agencies will be employed, this is usually a short period of time, even though a number of countries use and allow long-term engagement. Temporary work agencies usually employ workers for an indefinite period of time. Most countries seek to achieve equal treatment between workers from temporary work agencies and permanent employees of the companies using these agencies via bylaws and collective agreements. A large number of countries have developed a legal basis for the work of these agencies, which are constantly expanding and simplifying, so as to enable the sectoral growth of the economy.

New EU Member States have mostly formulated the basis for these agencies by adopting the recommendations of the ILO, as well as comparative practices of developed countries. Licensing is supported by strong ethics and good practice in management, where the employers are constantly getting better at organising their national sectors. This is especially the case for new EU Member States, and candidates that mostly lack collective bargaining regulations at a sectoral level for the sector of temporary work. This explains certain limitations in the growth and scope of temporary work agencies in these countries. Without the capacity of social partners for effective regulation, the promotion and development of this efficient form of employment will depend on the law for both partners. The partners being companies that use temporary work agencies and individual employees of these agencies, where reducing the political goals of the unions and agencies is needed. Regulation in this respect helps agencies to function the way they should, and normalises this segment in its infancy. The need for the legislature, legal regulation and collective bargaining is essential in order to achieve an effective balance between flexibility of employment, equality and security. Some countries with sophisticated arrangements for collective bargaining show greater efficiency when it comes to flexible employment and total employment, providing greater protection and easier and continuous growth of temporary work agencies. The focus is placed on the diversification of risk, the Department of labor, achieving greater work efficiency and flexibility. The practice of temporary work agencies can be an efficient tool for organising different types of economic activities of companies from the perspective of macroeconomics in countries of the European Union.

The European Commission with its services Directive intends to allow the free flow of services throughout Europe, eliminating the principle of "country of origin" in the section on human resources, which should enable equal treatment and equal conditions across Europe for temporary work agencies and their workers, regardless of which country the agency was established in.

The basic conditions of work and employment envisaged by the EU Directive are:

- Payment,
- Rules regarding night and overtime working hours, Annual and other vacations,
- Working conditions for pregnant women and single mothers,
- Safety at work for children and young employees,
- Discrimination protection of gender, race, origin, ethnicity, and disability, beliefs and religion.

4. METHODS AND MATERIALS

In 2016 there were field research provided with 98 employers representing crafts and SMEs, on the attitude and practice in flexible patterns of work. The purpose of the research was to present the positive and negative aspects of economic needs and legal regulations of labor market flexibility issues. Here are presented key results on the experience of the employers in these working.

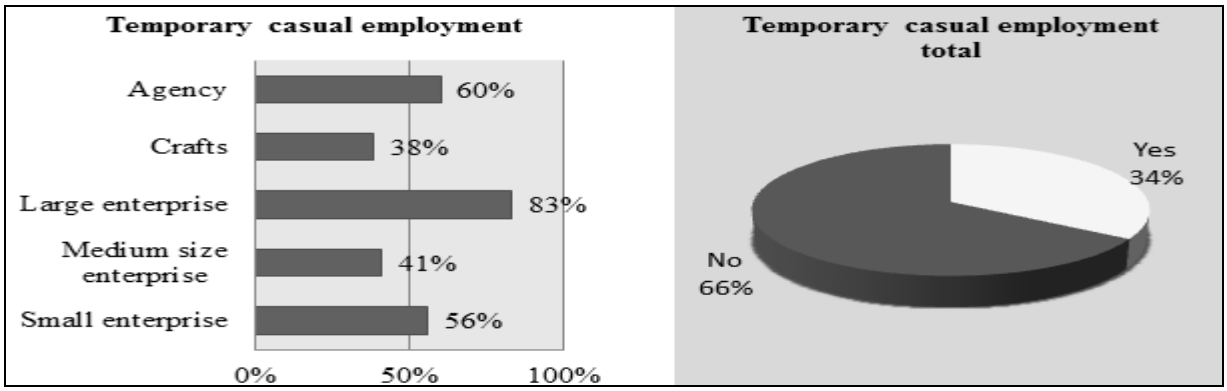
Evidence from the employers experience from Croatia, Montenegro, Serbia and Macedonia

There are two main legal aspects related to the work of temporary work agencies. The first is legally regulating the activities of temporary work agencies and the second is regulating labour laws concerning contracts and work tasks. The business activities of these agencies are primarily regulated through licensing and oversight procedures of their work, where some countries determine the areas and sectors where agencies should not operate or provide workers. In Balkan countries, labour laws do not primarily regulate contracts of employment, but the tasks and the purpose of the work being done in companies that use workers from these agencies. Collective agreements also have a role in regulating tasks and contracts. In Balkan countries this is regulated in a similar way, except for Serbia, where a law has not been passed in relation to flexible forms of work, in addition to there not being a law concerning temporary work agencies. Hence, there is a legal vacuum that leads to numerous irregularities. The legal entities or the target groups whose views on flexible forms of employment are empirically researched in the framework of this paper are 98 enterprises, small, medium-sized and large enterprises, craft shops and self-employed individuals which have had a vast amount of experience in employing workers according to the principle of flexible working patterns. A more detailed insight into this experience is given below.

a. Temporary casual employment

A great deal of legal entities (66% of respondents) has used temporary casual employees in the past. This way of employment was mostly used by large enterprises, 83% of them, next there are agencies and self-employed individuals with 60%, 56% of small enterprises have used this form of employment, as well as 41% of medium-sized enterprises and 38% of craft shops.

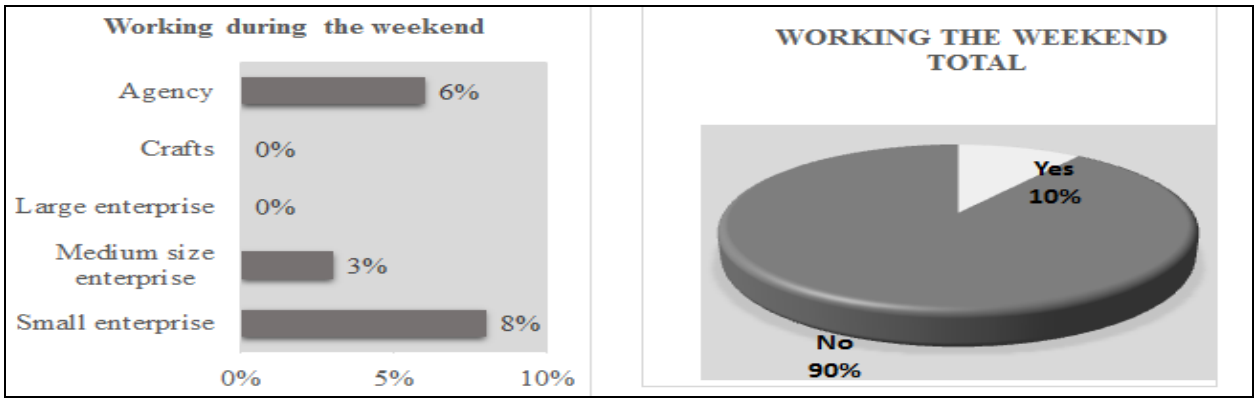
Chart following on the next page



Charts: Enterprises experience in temorary casual employment
Source. Authors

b. Working during the weekend

When it comes to enterprises, 10% of the respondents have hired people to work during the weekend. This form of employment was mostly used by small enterprises, 8% of them, in addition to 6% of agencies and self-employed individuals and by 3% of medium-sized enterprises.

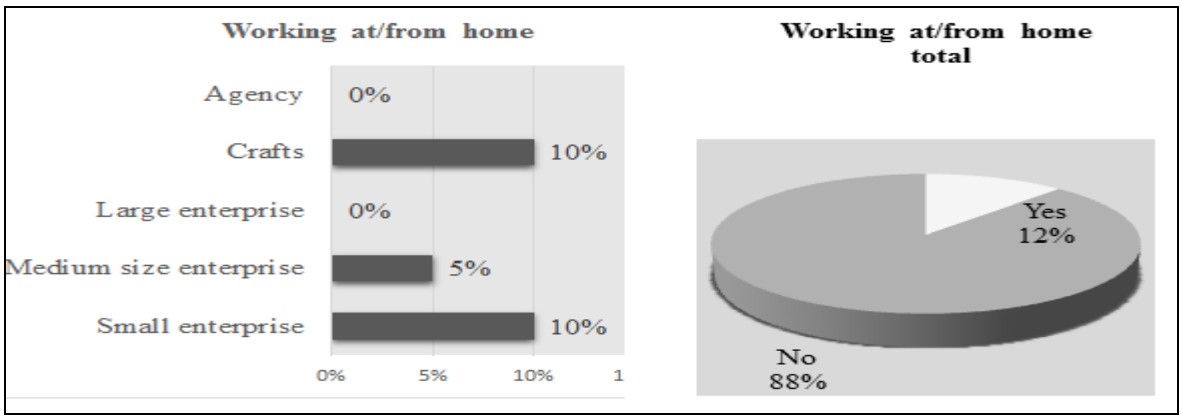


Charts: Enterprises experience in working during the weekend
Source. Authors

c. Working at/from home

Hiring people to work from home was used by 12% of legal entities in 2016 from the total number of respondents. This form of employment was mostly used by small businesses, 10% of them, followed by 10% of craft shops, and 5% of medium-sized enterprises.

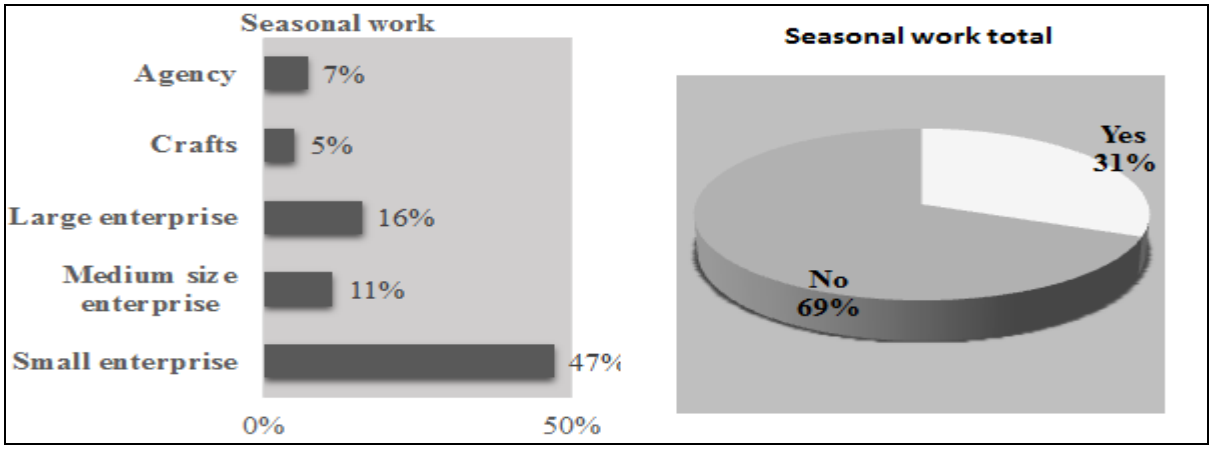
Chart following on the next page



Charts: Enterprises experience in working at/from home
Source. Authors

d. Seasonal work

Out of the interviewed legal entities, 31% have used this form of hiring workers in 2016. This form of employment was mostly used by small enterprises, 47% of them, 16% of large enterprises, 11% of medium-sized enterprises, 5% of craft shops and 7% of agencies and self-employed individuals.

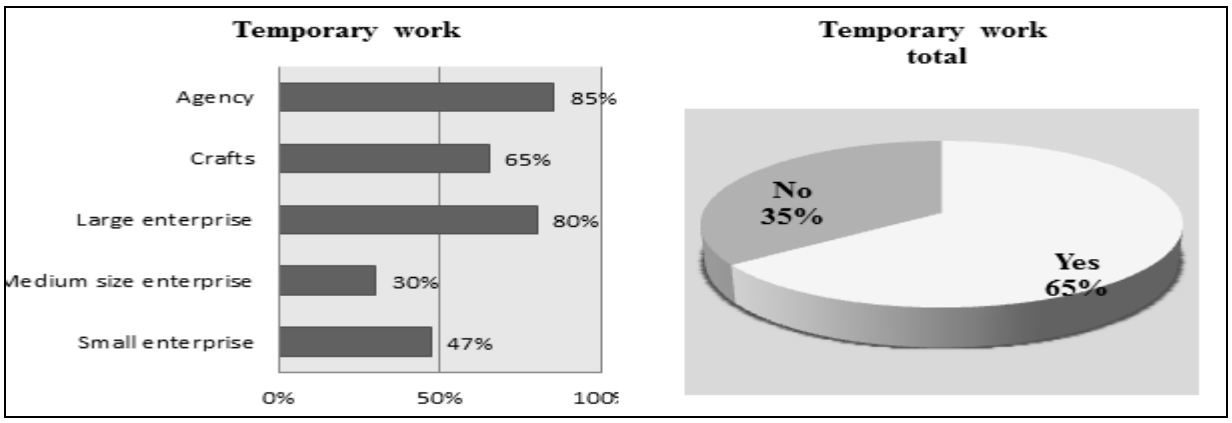


Charts: Enterprises experience in seasolnal work
Source. Authors

e. Temporary employment

Regarding legal entities, 65% of respondents have used temporary employment in the previous period. This form of employment was mostly used by agencies and self-employed individuals, 83% of them, by 80% of large enterprises, 65% of craft shops, 47% of small enterprises and 30% of medium-sized enterprises.

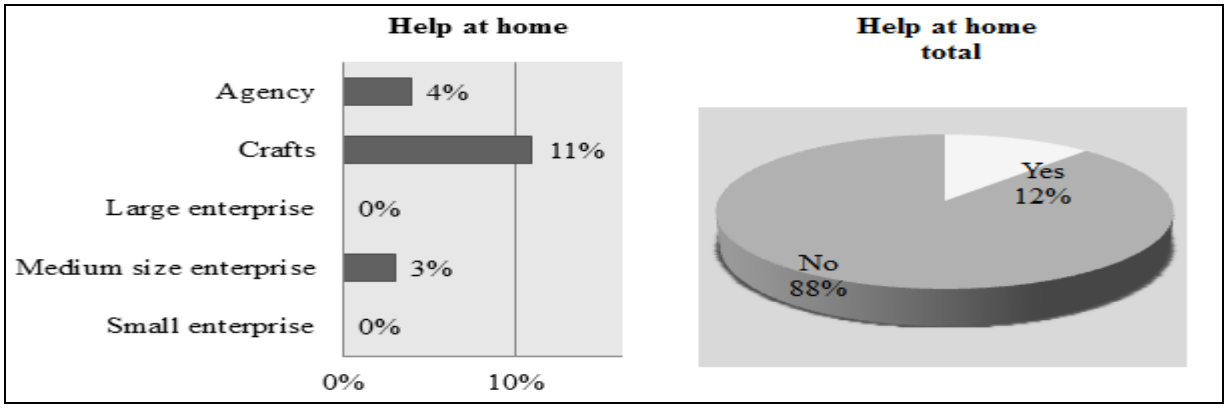
Chart following on the next page



Charts: Enterprises experience in temorary employment
Source. Authors

f. Help at home

A small number of legal entities have hired workers to help them at home; only 12% of respondents have used this work pattern. It was mostly used by agencies and self-employed individuals, 14% of them, followed by 11% of craft shops and 3% of medium-sized enterprises.

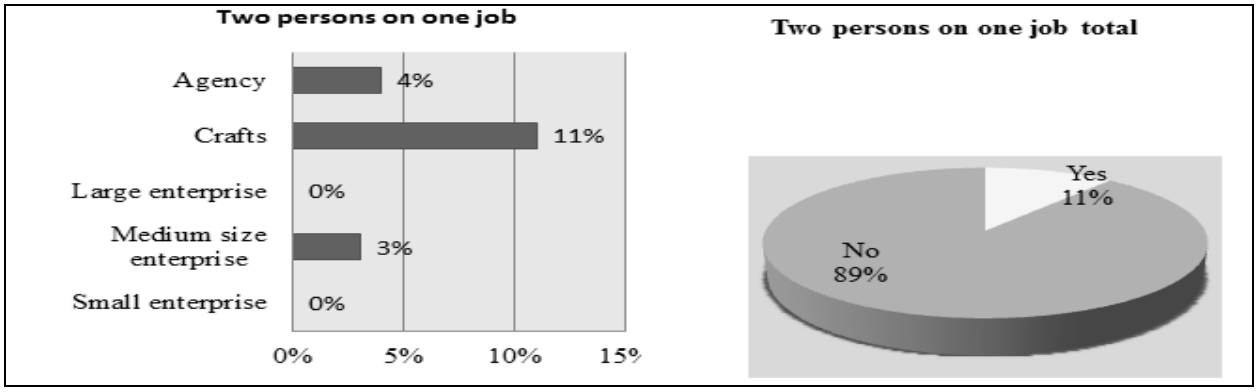


Charts: Enterprises experience in help at home working
Source. Authors

g. Hiring two people for one position

This form of employment was used by a small number of legal entities; only 11% of respondents did this in the previous period. It was mostly used by large enterprises, 16% of them, followed by 11% of craft shops and 6% of medium-sized enterprises.

Chart following on the next page



Charts: Enterprises experience in two persons on one job working
Source. Authors

4. DISCUSSION AND CONCLUSIONS

Flexible work which is the subject of the research in this paper is therefore an ambiguous concept: on the one hand, it is a prerequisite for short term, economic success and competitive advantages, while at the same time, flexible work might be criticized for its negative effects on workers and society, mainly not very good accepted in small Balkan countries economies, where the legislative on flexible work patterns is not completed, as well not transparent to EU best practices**.** In the eyes of trade unions and workers, increased international competition in goods and service markets has been having negative implications on labour conditions and, in this respect, upon the number of hours that employees have to work and on the schedules that they have to accept. These changes can so threaten the idea of a Social Europe and potentially undo many of the gains in employment quality obtained over the past fifty years. The evidence provided in this paper concerning legal aspects suggests that the major changes currently taking place in relation to working time relate to its arrangement rather than its duration. Nonetheless, over recent years, the decline in the number of working hours has also slowed, and in some countries working hours may even have begun to increase. The paper also stresses significant variation in working patterns and regulation across Europe. Member states as well as candidate countries might be facing similar economic pressures to reform the organisation of work in order to realise higher efficiency, but they are not at the same positions from a regulatory, institutional, economic, or social perspective. In response, the working time debate – as presented by the social partners - has shifted to the flexible organisation of working time: from the employer side, the need to increase efficiency; from the employee side, the need for a better work-life balance. In the absence of high inflation that tends to concentrate minds on pay bargaining, the issue of working time arrangements has, arguably, moved up the industrial / employee relations agenda.

LITERATURE:

1. Atkinson, J. (1984). Manpower strategies for flexible organisations. *Personnel Management, 16(8),* 28-31.
2. Beck, U. (2000). *The brave new world of work.* Cambridge, UK: Polity Press
3. Cooper, M. (2008). The inequality of security: Winners and losers in the risk society. *Human Relations, 61(9),* 1229-1258.
4. Doogan, K. (2001). Insecurity and long-term employment. *Work, Employment & Society, 15(3),* 419-441.

5. Duncan, R.B. (1976). The ambidextrous organization: Designing dual structures for innovation. In Pondy, L.R., & Slevin, S.P. (Eds.), *The management of organization* (pp. 167-188). New York: Oxford.
6. Eurofund (2015). European Working Conditions Surveys: 1991-2005, available at: https://www.eurofound.europa.eu/surveys/european-working-conditions-surveys
7. Hesseling, D.J.K. & van Vuuren, T. (1999). Job flexibility and job insecurity: The Dutch case. *European Journal of Work and Organizational Psychology*, *8(2),* 273-293.
8. Höge, T. (2011). Perceived flexibility requirements at work and the entreployee-workorientation: Concept and measurement. *Psychology of Everyday Activity*, *4(1),* 3-21.
9. Hornung, S., Herbig, B., & Glaser, J. (2008). Mitarbeiterorientierte Flexibilisierung: Konzeptgeleitete Evaluation eines Fallbeispiels aus der öffentlichen Verwaltung. *Psychology of Everyday Activity*, *1(1),* 33-43.
10. Johnsson, D. (2006). Flexibility, stability and related concepts. In Furaker, B., Hakansson, K., & Karlsson, J. (Eds.), *Flexibility and stability in working life*. Basingstoke: Palgrave.
11. Kozica, A., & Kaiser, S. (2012). A sustainable perspective on flexible HRM: How to cope with paradoxes of contingent work. *Management Revue*, *23(3),* 239-261.
12. Lai, P.C., Soltani, E., & Baum, T. (2008). Distancing flexibility in the hotel industry: The role of employment agencies as labor suppliers. *The International Journal of Human Resource Management*, *19(1),* 132-152.
13. Lambert, S. J. (2008). Passing the buck: Labor flexibility practices that transfer risk onto hourly workers. *Human Relations, 61(9),* 1203-1227.
14. Mayne, L., Tregaskis, O., & Brewster, C. (1996). A comparative analysis of the link between flexibility and HRM strategy. *Employee Relations, 18(3),* 5-24.
15. Pollert, A. (1991). The orthodoxy of flexibility. In Pollert, A. (Eds.), *Farewell to flexibility?* (pp. 3-31). Oxford: Blackwell.
16. Raisch, S., Birkinshaw, J., Probst, G., & Tushman, M.L. (2009). Organizational ambidexterity: Balancing exploration and exploitation for sustained success, *Organization Science*, *20(4),* 685-695.
17. Reilly, P.A. (1998). Balancing flexibility – Meeting the interests of employer and employee. *European Journal of Work and Organizational Psychology, 7(1),* 7-22.
18. Sennett, R. (1998). *The corrosion of character: The personal consequences of work in the new capitalism*. New York: W.W. Norton.
19. Sydow, J., Schreyögg, G., & Koch, J. (2009). Organizational path dependence: Opening the black box. *Academy of Management Review, 34(4),* 689-709
20. Wright, P., & Snell, S. A. (1998). Toward a unifying framework for exploring fit and flexibility in strategic Human Resource Management. *Academy of Management Review, 23(4),* 756-772.

JUDICIAL COOPERATION BETWEEN THE COURTS OF THE MEMBER STATES IN THE TAKING OF EVIDENCE IN CIVIL OR COMMERCIAL MATTERS

Dinka Sago
Faculty of Law, University of Split
Domovinskog rata 8, Split, Croatia
dsago@pravst.hr

ABSTRACT

On 1 January 2004, Council Regulation (EC) 1206/2001 of 28 May 2001 on Cooperation between the Courts of the Member States in the Taking of Evidence in Civil and Commercial Matters became applicable. This paper analyze basic principles of the Regulation. The courts in a requesting state can ask courts in another Member State to take evidence directly or through a central body. First, the evidence taking using the international legal aid (direct transmission between the courts) and second, direct taking of evidence by the requesting court. An effort is required on the part of all the States, first to introduce the technology into the judicial administration, and then to provide information about the available resources in an effective manner. The main purpose of the Regulation is to make the taking of evidence in a cross-border context simple, effective and swift manner in another Member State through direct contact with judicial authorities of the latter. Because of that the taking of evidence procedure in another Member State must not lead to the lengthening of national proceedings. Paper analyzes some problems, first of all unification of law of evidence which would be very difficult because of ground-breaking conceptual differences between law of civil procedure and law of evidence in particular of Member States, but by encouraging judicial cooperation. The main improvement of this Regulation is removing of need to transmit the request to the central authority. One of the most important improvement is that Regulation accelerated the procedure of evidence taking by fixing the time limit for the execution of the activities. Another important principle is that the request is executed in accordance with the national law of the requested court.

Keywords: *civil, commercial matters, evidence, legal aid*

1. INTRODUCTION

Regulation No. 1206/2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters entered into force in 2001. The Regulation is valid for 27 of the 28 Members from the date of accession, except of Denmark who is ruled by The Hague Convention of the taking of evidence abroad in civil or commercial matters of 18 March 1970. A regulation is a binding legislative act. It must be applied directly in its entirety across the EU. National governments do not have to take any action themselves to implement it, but it is desirable, that national law has provisions which facilitate the application of a regulation (Bačić, Bačić, 2007, p. 138 – 140).

Croatia is a Member State of the EU since 1 of July 2013. By the Act on Adoption of the Civil Procedure Act as of 26 June 1991, the Republic of Croatia took over the Civil Procedure Act (CPA) from the former Yugoslav Republic and implemented it into its legal system. The CPA is the main legal source regulating litigation in the Republic of Croatia (Šago, 2013, p. 116). The latest modifications in the CPA are aimed at promoting the efficiency and effectiveness of the litigation procedure, ensuring an additional harmonization of the national legislation in compliance with the recommendations of the Council of Europe and building certain EU directives into the national legal system (Sikirić, 2008, p. 101 - 126). In the Part IV of the Croatian CPA titled European Civil Procedures are located provisions

about implementation of Regulations regarding: service of judicial and extrajudicial documents in civil or commercial matters (Art 507. a – 507. č); taking of evidence (Art 507. d - 507. h); order for payment procedure (Art 507. i – 507. nj) and procedure in small claims disputes (Art 507. o – 507. ž). So, taking of evidence according to the Regulation in the Republic of Croatia is laid down in Articles 507 d to 507 h of the Civil Procedure Act (Official Gazette of the Republic of Croatia, no. 53/91, 91/92, 112/99, 88/01, 117/03, 88/05, 02/07, 84/08, 96/08, 123/08, 57/11, 148/11, 25/13, 89/14).
Each EU country has drawn up a list of the courts competent to take evidence according to the Regulation. This list also indicates the territorial jurisdiction of those courts. Each EU country has designated a central body responsible for supplying information to the courts and seeking solutions to any difficulties arising in respect of a request. The Croatian Ministry of Justice is the competent authority referred to Article 3(3) of the Regulation No 1206/2001 (Aras Kramar, 2015, p. 40).
The Regulation provides for two means of taking evidence in another EU country: the court before which a case is heard in one EU country can request the competent court of another EU country to take the necessary evidence; or it can instead, take evidence directly in another EU country. This Regulation has created a European system of direct and rapid transmission and execution of requests, in which the requests for taking evidence are transferred directly from the „requesting court“ to the „requested court“.

2. TAKING OF EVIDENCE

The concept of “civil and commercial matters” should be understood as an autonomous concept of Community law. Therefore an independent definition should be made of what is to be understood by civil or commercial matters for the purposes of the Regulation (Final report, 2007, p. 98.). 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 fact that the concept of "evidence" is not defined in the Regulation on Evidence has created difficulties. This has lead to significantly diverging interpretations of what is considered as "evidence" in the sense of the Regulation (Betetto, 2007, p. 138 – 139). The importance of the definition of evidence or classification of the concepts dealt with in the Regulation is due to the diversity of the Member States’ national laws, which may have different ideas about what is meant by the terms “civil or commercial matters”, “evidence” or “court”. So as to avoid, as far as possible, any future problems of classification, a definition of the Regulation’s material scope will first be necessary (Final report, 2007, p. 98.).

2.1 Transmission and execution of requests

The beginning of the procedure for assistance for evidence taking abroad revolves around the “request”. The objective of the “request” may be either the taking of evidence by a foreign court or the performance of taking of evidence by the competent authority itself or a representative thereof. According to the Article 4 the request shall contain: a) the requesting and, where appropriate, the requested court; b) the names and addresses of the parties to the proceedings and their representatives, if any; c) the nature and subject matter of the case and a brief statement of the facts; d) a description of the taking of evidence to be performed; e) where the request is for the examination of a person: the name(s) and address(es) of the person(s) to be examined, the questions to be put to the person(s) to be examined or a statement of the facts about which he is (they are) to be examined, where appropriate, a reference to a right to refuse to testify under the law of the Member State of the requesting court, any requirement that the examination is to be carried out under oath or affirmation in lieu thereof, and any special form to be used, where appropriate, any other information that

the requesting court deems necessary; where the request is for any other form of taking of evidence, the documents or other objects to be inspected; where appropriate, any request pursuant to Article 10(3) competent court shall send an acknowledgement of receipt to and (4), and Articles 11 and 12 and any information necessary for the application thereof.
The request and all documents accompanying the request shall be exempted from authentication or any equivalent formality. Documents which the requesting court deems it necessary to enclose for the execution of the request shall be accompanied by a translation into the language in which the request was written. The main improvement of this Regulation is removing of need to transmit the request to the central authority. The judge of a requesting court sends a request directly to the judge of requested court (Betetto, 2006, p. 137 – 144). Member States are supposed to draw up a list of the courts authorised to take evidence, indicating the territorial or special jurisdiction of these courts. According to the Article 5 the request and communications pursuant to Regulation must be drafted in the official language of the requested Member State or, if there are several official languages in that Member State, in the official language or one of the official languages of the place where the requested taking of evidence is to be performed, any other language that the requested Member State has indicated it can accept. Each Member State shall indicate the official language or languages of the institutions of the European Community other than its own which is or are acceptable to it for completion of the forms (Bojić, 2015, p. 706).

2.2 Receipt of request

Another importan improvement is that Regulation accelerated the procedure of evidence taking by fixing the time limit for the execution of the activities. That means that the requested court must send to the requesting court the acknowledgement of receipt of a request for the taking of evidence within seven days of receipt of request. The deadlines include also that the requested court must within 30 days notify the requesting court if information is missing or a deposit or advance is necessary and most importantly, requested court which has received a complete request is obliged to execute it within 90 days, if it is not possible to execute within 90 days the requested court is under an obligation to inform the requesting court of the grounds for the delay and give an estimate of the time it will take for execution (Storskrubb, 2008, p. 120).
According to the Article 8 if a request cannot be executed because it does not contain all of the necessary information pursuant to Article 4, the requested court shall inform the requesting court thereof without delay and, at the latest, within 30 days of receipt of the request using form C in the Annex, and shall request it to send the missing information, which should be indicated as precisely as possible. If a request cannot be executed because a deposit or advance is necessary in accordance with Article 18(3), the requested court shall inform the requesting court thereof without delay and, at the latest, within 30 days of receipt of the request using form C in the Annex and inform the requesting court how the deposit or advance should be made. The requested Court shall acknowledge receipt of the deposit or advance without delay, at the latest within 10 days of receipt of the deposit or the advance using form D.

2.3 Taking of evidence by the requested court

According to the Article 10 the requested court shall execute the request without delay and, at the latest, within 90 days of receipt of the request. Another important principle is that the request is executed in accordance with the national law of the requested court. The requesting court may also ask for the request to be executed in accordance with a special procedure provided for by the law of its Memer States. The requested court shall comply with such a requirement unless this procedure is incompatible with the law of the Member States of the

requested court or by reason of major practical difficulties (using videoconference and teleconference).
According to the Article 11 if it is provided for by the law of the Member State of the requesting court, the parties and, if any, their representatives have the right to be present at the performance of the taking of evidence by the requested court. The representatives of the requesting court may also be present (Włosińska, 2013, p. 1 - 9). The requested court informs the representatives about the time and place of evidence taking and may determine conditions under which they may participate. During the performance of the request the requested court may use necessary coercive measures provided by the law of the Member State of the requested court (Šago, 2013, p. 119). The possibility of refusing to execute the request for the performance of taking of evidence is confined to strictly limited situations. A request for the hearing of a person shall not be executed when the person concerned claims the right to refuse to give evidence or to be prohibited from giving evidence, a) under the law of the Member State of the requested court or b) under the law of the Member State of the requesting court, and such right has been specified in the request or if need be, at the instance of the requested court, has been confirmed by the requesting court. If the requested court is not in a position to execute the request whitin 90 days of receipt, it shall inform the requesting court thereof (Medić Musa, 2005, p. 336 – 338). The individuals and their representatives could participate in the process in the other Member State if that right is provided by the law of the Member State of requesting court or the conditions of taking of evidence is set by the requesting court.
If it is compatible with the law of Member State of the requesting court and it could result better assess of the evidence, representatives have the right to be present in the performance of the taking of evidence by the requested court.
The Article 14 of the Regulation No 1206/2001 sets out The grounds for refusal of a request and the list of the grounds is exhaustive, thus the requested court was not entitle to require to cover witness expenses in advance (EUCJ case No. C-283/09, 17.02.2011).
According to the Article 16 the requested court shall send without delay to the requesting court the documents establishing, the execution of the request and, where appropriate, return the documents received from the requesting court. The document shall be accompanied by a confirmation of execution. The execution of the request shall not give rise to a claim for any reimbursement of the taxes and costs, with the exemption of: a) fees paid to experts and interpreters, b) the costs of usage of communication technologies. The duty for the parties to bear the cost is governed by the national law of the Member state of the requesting court (Šago, 2013, p. 119).

2.4 Direct taking of evidence by the requesting court

The second method is the direct evidence taking. In order to facilitate the taking of evidence it should be possible for a court in a Member State, in accordance with the law of its Member State, to take evidence directly in another Member State, if accepted by the latter, and under the conditions determined by the central body or competent authority of the requested Member State (Paragraph 15 of the Preamble). Direct taking of evidence may only take place if it can be performed on a voluntary basis without the need for coercive measures. (Clause 2 of the Article 17). The evidence should be taken in accordance with the requested state law and positions of the Clause 4 of the Article 17.
The form should be filled, can be taken to the Minister of Justice or may be assigned a court of its Member State to take part in the performance of the taking of evidence in order to ensure the proper execution of the conditions that have been set out in the Regulation. A request for the direct taking of evidence must be submitted to the central body or competent authority of the requested Member State and can be refused only in exceptional

circumstances. Direct taking of evidence may only take place where this can be performed on a voluntary basis. The authorization allowing the requesting judge must be given or denied within 30 days. Central Authority will only control if the request should not be refused for one of the reasons started in Regulation and if the performance of the taking of evidence should not be subject to certain conditions (Nuyts, Sepulchre, 2004, p. 334). Direct evidence taking can be performed on a voluntarily basis without the need of coercive measures. Where the direct taking of evidence implies that a person shall be heard, the requesting court must inform that person that the performance is to take place on a voluntary basis. This method has some advantages: saves time, the collection of evidence can be done by one single person, only requires a passive collaboration of the requested state (Nuyts, Sepulchre, 2004, p. 333).
Within 30 days of receiving the request, the central body or the competent authority of the requested Member State shall inform the requesting court if the request is accepted and, if necessary, under what conditions according to the law of its Member State the request is to be carried out. The evidence is to be taken by a member of the judicial personnel or by any other person such as a commissioner or an expert who has been designated in accordance with the law of the Member State of the requesting court.
The central body or the competent authority may refuse manual, which shall also be available direct taking of evidence only if: the information provided by the Member States in a) the request does not fall within the scope of this with Article 22 and the agreements or Regulation as set out in Article 1 (according to Article 21), b) the request does not contain all of the necessary information pursuant to Article 4; or c) the direct taking of evidence requested is contrary to fundamental principles of law in its Member State. Without prejudice to the conditions laid down in accordance with paragraph 4, the requesting court shall execute the request in accordance with the law of its Member State.

3. HEARING OF WITNESSES

Taking of evidence by hearing witnesses is the key means of proof because oral testimony is a significant instrument to find the truth in court decision and often it is also the only available means of proof which a judge can use. That is why most of the EU Member States regulate the process of getting testimony from witnesses in detail and that is also the reason why considerable differences in EU Member States procedural rules exist (Černovská, Hánělová, Chmel, 2016, p. 9). In the case of hearings under Articles 10, 11 and 12 the requested court notifies the party of the time and place of the hearing. But, according to the Article 17 of the Regulation 1206/2001 in the case of hearings the serving of summons is carried out by the requesting court.

3.1 Hearing of witnesses by mutual legal assistance

Courts offer legal assistance to foreign courts in the manner prescribed by domestic law. The action, which is the subject of the request by the foreign court, may be carried out in the manner requested by the foreign court if this procedure does not contravene the public order of the Republic of Croatia (Art. 182 CPA). The witness will be examined according to the provisions of the law of the requested Court's Member State (Art. 10/2) (Aras Kramar, 2015, p. 49).

3.2 Hearing of witnesses by videoconferencing with direct asking of questions

The Republic of Croatia has no special restrictions on the type of evidence that can be obtained by videoconference. The court conducting the proceedings decides what type of evidence will be taken, and how, in order to establish a certain fact. The court decides at its own discretion which of the facts it will consider as proven following a conscientious and careful assessment of each particular piece of evidence and of all pieces of evidence together,

based on the outcome of the entire process. However, videoconference is generally used for taking evidence by hearing the parties and witnesses, as there are certain factual and technical obstacles to taking evidence by inspecting a document or performing an inquiry on the spot. The videoconference can be used in accordance with Paragraph 10-12 of the Regulation when the court of the State in accordance with laws of its Member States, request the other competent court of the Member State to take evidence. The requested court shall execute the request in accordance with the law of its Member State. The requesting court may ask the requested court to use communications technology at the performance of the taking of evidence, in particular by using videoconference (Aras Kramar, 2015, p. 50). The requested court shall comply with such a requirement unless this is in compatible with the law of the Member State of the requested court or by reason of major practical difficulties. When the residence place of examined person is not at the same Member State of the Court, the oral examination should be conducted in accordance with the rules specified in Regulation No.1206/2001. Usually the person is examined in the official language of the requested Member State. If the person do not use this language, he should have a possibility of being assisted by an interpreter. Therefore in accordance with judge permission questions could be asked and answers could be provided not in the official language of the requested Member State. When a court requests to take evidence directly could be used the language of the requesting state but aninterpreter may be participate.

The taking of evidence shall be performed by a member of the judicial personnel or by any other person such as an expert, who will be designated, in accordance with the law of the Member State of the requesting court. Inparticular, the central body or the competent authority may assign a court of its Member State to take part in the performance of the taking of evidence in order to ensure the proper Regulation conditions that have been set out.

In the cases in which communications technology have been used, the problems refer to the need for simultaneous interpreters when videoconferences are used, and the lack of specialist technical staff. Use of communications technology appears to be more widespread in criminal proceedings than in civil proceedings. Despite the limited implementation of communications technology there is no doubt that the adoption of this communications technology in the EU Member States would be very useful, and would speed up the procedure and appreciably reduce costs (Final report, 2007, p. 66).

3.3 Direct hearing of witnesses by requesting court in requested country

There is no reference to direct hearing in Croatian national law. But in cases to which the Regulation No 1206/2001 applies: a single judge or an authorised member of the Council of the Croatian court that requires the taking of evidence may, in case to which the Regulation No 1206/2001 applies and according to this Regulation, to be present and participate in the taking of evidence requested by a foreign court. The parties, their representatives and experts may thereby participate to the extent in which they participate in the proceedings before the Croatian courts in the taking of evidence (Art. 507.e, para. 1 CCPA). A single judge or an authorised member of the Council of the Croatian court and witnesses that a Croatian court authorised can direct take evidence abroad according to the Article 17, paragraph 2 of the Regulation No 1206/2001 (Art. 507.e, para. 1 CCPA). If it is compatible with the law of the Member State of 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 (Art. 12/1).

4. THE COSTS OF TAKING EVIDENCE

Concept of costs must be defined autonomously under European Union law. Costs are sums paid by the court to third parties in the course of proceedings, in particular to experts or witnesses. Taxes are sums received by the court for carrying out its functions (EUCJ case No.

C - 283/09,17. 02. 2011). Costs and taxes are not reimbursable, despite if the requested court requires: 1. immediately to pay fees to experts and interpreters (can be requested for deposit); 2. the major practical difficulties (including costs arising from the use of communications technology).
According to the Article 18 of the Regulation 1206/2001 the duty for the parties to bear these fees or costs shall be governed by the law of the Member State of the requesting court. Where the opinion of an expert is required, the requested court may, before executing the request, ask the requesting court for an adequate deposit or advance towards the requested costs. In all other cases, a deposit or advance shall not be a condition for the execution of a request. The deposit or advance shall be made by the parties if that is provided for by the law of the Member State of the requesting court. The execution of the request shall not give rise to a claim for any reimbursement of taxes or costs. Nevertheless, if the requested court so requires, the requesting court shall ensure the reimbursement, without delay, of certain costs as follows: fees paid to experts and interpreters, and the costs occasioned by the use of any special procedure for the taking of evidence requested by the requesting court (Articles 10(3) and 10(4)). Only where expert evidence is to be taken may the requested court seek payment of an advance towards the costs of such evidence.

5. CONCLUSION

The law of evidence is one of the most important part of the civil procedure law of each country. The Regulation 1206/2001 represents only one segment of the new procedural regulation in the across the border disputes within EU. Despite of that, it is of extreme importance because, within the scope of its field of application, it replaced all up to then effective international instruments which bound the EU states. The aim of the Regulation is to make the taking of evidence in a cross - border context simple, effective and rapid (EUCJ Case No. C-104/03, 28 April 2005). Regulation does not restrict the options to take evidence situated in other Member States, but aims to increase those options by encouraging cooperation between the courts in that area (EUCJ Case No. C-332/11, 21 February 2013).
The main goal of European Civil Procedure is improving and facilitating judicial cooperation in civil and commercial matters between the Member States in all fields; improving the effective and practical application of Union instruments and conventions in force between two or more Member States; and promoting effective access to justice for the general public (Šago, 2013, p. 125 – 126). All Regulations represents a true advancement in the integration process, have signalled the begining of the creation of a European uniform civil procedure (Hodges, 2007, p. 96 – 123). The goals of which are to simplify, speed up, reduce the costs and language obstacles (Stadler, 2012, p. 151 – 168). They provide that the procedure they establish should serve as an additional, alternative means for applicants.
Today the harmonisation of different procedural rules would be very useful. Many of the features intended to simplify the procedure including standard forms, deadlines and less stringent translation rules are examined (Wagner, 2016, p. 9 – 17). 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 (Šago, 2013, p. 115 – 126).
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 (Poretti, 2016, p. 225.). 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.
Regulation 1206/2001 is a starting point for further harmonization, unification processes in this field. Regulation (EC) No 1206/2001 as well as cross-border taking of evidence within

the EU, contribute to the development of mutual trust in order to eliminate obstacles in cross-border civil proceedings, provide information to individuals and businesses to improve their access to justice (Ivanc, 2015, p. 8). Many countries are reforming their law of evidence is related to cultural and technological changes in modern societies. As the balance between, on the one side, traditional human rights such as the right to privacy and on the other side, the modern need for security, efficiency and quick access to justice, the perception of what is admissible or not in the context of evidence taking is changing as well. In the same sense, the fast pace of modern life commands different practices of fact finding, accompanied by new methods of selection of evidence that are appropriate for this purpose. On the end we can say that new technologies into all spheres of public and private life has the capacity to dramatically change the methods of the collection and presentation of evidence.

The law of evidence of the EU Member States is based on similar principles, such as the free evaluation of evidence. It would be useful to set down the list of some of the principles or rules which should be followed in civil proceedings in all EU Member States (Černovská, Hánělová, Chmel, 2016., p. 18). Taking of evidence abroad may result in violation of some rights of procedural law, such as principle of equality of arms. Because, both parties to proceedings should have equal right to provide evidence. The problem is when witnesses provided by those parties, are heard under different conditions. This can result with advantage to one of the parties. That means that the procedural rights of the witnesses might appear violated (Černovská, Hánělová, Chmel, 2016., p. 15). In spite of difficulties we believe that the cooperation in the taking of evidences in civil and commercial matters in the EU it will continue to improve in the future.

LITERATURE:

1. Aras Kramar, S. (2015). *Evidence in Civil Law – Croatia,* Lex Localis. Institute for Local Self – Government and Public Procurement Maribor. p. 1- 55.
2. Bačić, A., Bačić, P. (2007). *Europsko pravo – studijski izvori*, Pravni fakultet Sveučilišta u Splitu. Split
3. Betetto, N. (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. No. 4. p. 137 – 144.
4. Betetto, N. (2007). *Izvođenje dokaza van granica nacionalne države u Europskoj uniji*, European Lawyer Journal. n. 1. p. 137-148.
5. Bojić, V. (2015). *Primjena Uredbe Vijeća (EZ) br. 1206/2001 od 28. svibnja 2001. o suradnji između sudova država članica u izvođenju dokaza u građanskim ili trgovačkim stvarima,* Savjetovanje Aktualnosti hrvatskog zakonodavstva i pravne prakse. Zagreb: Godišnjak 22. Organizator. p. 701 – 710.
6. Civil Procedure Act (Official Gazette of the Republic of Croatia, no. 53/91, 91/92, 112/99, 88/01, 117/03, 88/05, 02/07, 84/08, 96/08, 123/08, 57/11, 148/11, 25/13, 89/14).
7. 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; see OJ L 174, 27.6.2001.
8. Černovská, V., Hánělová, K., Chmel, J. (2016) Principles of the Law of Evidence in Relation to the EU Cross – border Civil Proceedings, Themis competition, Semi – final C – International Judicial Cooperation in Civil Matters – European Civil Procedure, Lisbon. Portugal. p. 1 – 20.
9. Final report 1206_A_09032007 (2007). *Study on the application of Council Regulation (EC) No 1206/2001 on the taking of evidence in civil or commercial matter*
http://ec.europa.eu/civiljustice/publications/docs/final_report_ec_1206_2001_a_09032007.pdf

10. Hodges, C. (2007). *Europeanization of civil justice; trends and issues*. Civil Justice Quarterly 26, p. 96-123.
11. Ivanc, T. (2015) Evidence in Civil Law – Slovenia, Lex Localis, Institute for Local Self – Government and Public Procurement Maribor. Maribor. p. 1 – 123.
12. Medić Musa, I. (2005). *Uredba Vijeća (EZ) br. 1206/2001 o suradnji između sudova država članica na području izvođenja dokaza u građanskim ili trgovačkim predmetima*, Zbornik radova trećeg međunarodnog savjetovanja Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse. Mostar. p. 329 – 340.
13. Nuyts, A.; Sepulchre, Joe. (2004). *Taking of Evidence in the European Union under EC Regulation 1206/2001*. Business Law Internatinal. Vol. 5. No. 3. p. 334.
14. Poretti, P. (2016). *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*, 16th International Scientific Conference on Economic and Social Development - „The Legal Challenges of Modern World". Book of Proceedings. Split. p. 219 – 226.
15. 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.pd
16. Sikirić, H. (2008). *European civil litigation procedures and judicial cooperation in civil matters*. Novela Zakona o parničnom postupku iz 2008. Dika, Mihajlo (ur.). Zagreb: Narodne novine. p. 101-126.
17. Stadler, A. (2012). *Practical obstacles in cross-border litigation and communication between (EU) courts*. Erasmus Law Review. Volume 5. Issue 3. p. 151-168.
18. Storskrubb, E. (2008). *Civil Procedure and EU Law: a policy area uncovered*. Oxford University Press. p. 120.
19. 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 - Lisabon, Outcome of the SEE Graduates EU Law Teaching & Research Academy 2013 Collection of Papers* / Giegerich, Thomas et. al (ur.). (ur.). Skopje, Saarbrucken: Deutscher Akademischer Austausch Dienst (DAAD). p. 115-126.
20. Wagner, R. (2016). *Aktualni razvoj u području pravosudne suradnje u građanskim stvarima*. Zagreb: Hrvatska pravna revija. No 1. p. 9 – 17.
21. Włosińska, A. (2013). *Taking of evidence between EU Member States (some remarks on a substantive scope of application of the EU Evidence Regulation*)" (paper presented at the Conference 'Tis Forty Years Since: Britain & Ireland in Europe, Europe in Britain & Ireland.' The changing landscape of theory and practice. The University of Edinburgh. Edinburgh Law School.
http://blogs.sps.ed.ac.uk/sls/files/2013/08/Aleksandra-W%C5%82osi%C5%84ska_.pdf

AN OVERVIEW OF THE ADMINISTRATIVE JUSTICE IN THE REPUBLIC OF MACEDONIA

Blerton Sinani
Faculty of Law, South East European University, Tetovo, Macedonia
blerton.sinani@seeu.edu.mk

ABSTRACT

Administrative justice/judiciary, as a specialized judicial instance which is part of the organizational framework of the judicial system of the Republic of Macedonia, whose fundamental intention lies in the improvement and consolidation of the efficiency, diligency and frugality of judicial control over the final individual administrative acts, related to the issue whether they are adopted in compliance with legal acts of the respective administrative-legal domain, and whether they are adopted in accordance with the administrative-legal procedure prescribed by law, as well as the legal protection of rights and legal interests of private parties (natural persons and organizations) vis-à-vis administration and the commitment to the rule of law in administrative law area as an important legal area of the legal system of the Republic of Macedonia.

Keywords: *Administrative justice/judiciary; administrative dispute; legal protection of human rights; European standards; rule of law; independent and impartial administrative justice*

1. INTRODUCTION

The term "administrative justice/judiciary" is used to mean the state judicial authority that performs the function of judicial control of the legality of the final individual administrative acts, whereas the term "administrative dispute" is used about the case of illegality (incompatibility) between the final individual administrative act and the legal act as a general normative act. The justice administered by the administrative courts is looked upon as superior to “administrative justice.” Namely, the administrative justice or the settlement of administrative disputes by the administrative judiciary is the highest expression of administration of justice.[1]

Administrative justice/judiciary, as a specialized judicial instance which is part of the organizational framework of the judicial system of the Republic of Macedonia, whose fundamental intention lies in the improvement and consolidation of the efficiency, diligency and frugality of judicial control over the final individual administrative acts, related to the issue whether they are adopted in compliance with legal acts of the respective administrative-legal domain, and whether they are adopted in accordance with the administrative-legal procedure prescribed by law, as well as the legal protection of rights and legal interests of private parties (natural persons and organizations) *vis-à-vis* administration and the commitment to the rule of law in administrative law area as an important legal area of the legal system of the Republic of Macedonia.

Administrative justice/judiciary is facing new challenges in the accession process of the Republic of Macedonia to the European Union – harmonization[2] of procedural norms with the *acquis communitere* (i.e. the legislation of the European Union).

[1] Љубомир *Радовановић, О административном судству*, Архив за правне и друштвене науке, бр. 1/1922, p. 29-37.

[2] In a general sense, the harmonization is a contemporary process of legal globalization in general, and administrative law in particular, in European and global frameworks, that is to say that it is a characteristic trend in the current stage of the development of administrative law - quoted according to Љубомир Секулић, *Основи управног права*, Подгорица, 2004, p. 22.

To reach the European standards, administrative justice/judiciary is faced with new demands, and primary they are:[3]

First, the right of the administrative court to determine the factual situation in every administrative dispute;

Second, the right of the administrative court to conduct public oral contradictory hearings in administrative disputes, in order to determine the factual situation, and provide legal protection of the rights of parties;

Third, the right of parties to submit an appeal over the decision of the Administrative court, which brings forth the need to have several instances of judgment,[4] that allow for greater legal certainty, and complete and proper oversight of the factual situation that was determined in the first instance;

Fourth, the efficacy of the judicial proceedings, shortening of the proceedings and reducing the backlog in adjudicating.

These were the reasons for the Assembly of the Republic of Macedonia to promulgate the Law on Administrative Disputes on 19 May 2006, published in the Official Gazette of the Republic of Macedonia No. 62/2006, entered into force on 26 May 2006.[5] In accordance with the deadline set in article 69 from the Law on administrative disputes of the Republic of Macedonia the Administrative court was supposed to start working in May 2007. Therefore, the Administrative court was not formed in the legally defined period, that is to say that the work of the Administrative court was delayed. However, it was not a legal prolongation, but it was a factual prolongation without any legal basis for over half a year.[6] The relatively long time period to start the real implementation of the Law on administrative disputes, *inter alia*, was a consequence of the creation of administrative-technical and judicial infrastructure preconditions (judicial staff and judicial administration were needed – personnel for expert, administrative, technical and other assignments; the new court building to comply with standards to allow functionality and efficiency in the work of the administrative judges; to use the system of electronic information technology etc), and especially the specific judicial human resources (even though at that time not even the administrative judges were elected)[7] to take in consideration the administrative disputes in order to allow the application of that law in practice.

[3] Ivan Koprić, *Upravno sudovanje u svjetlu prilagodbe standardima EU-a*, Reforma upravnog sudstva i upravnog postupanja, Zagreb, 2006, p. 58-63.

[4] The principle of several instances comes out from the basic right of appeal to court decisions in the first instance (Constitution of Republic of Macedonia of 1991, Amendment XXI), and from the need to have efficient functioning of the judicial system, for which it has to have a pyramid structure. The pyramid structure of Administrative judiciary is created by: the Administrative court, Higher administrative court and Supreme court of the Republic of Macedonia as the highest court, providing uniformity in the implementation of the laws by the courts. that secures the unity of implementing the law by all courts (Constitution of Republic of Macedonia of 1991, Article 101).

[5] Кирил Чавдар, Кимо Чавдар, *Коментар на Законот за управните спорови*, Скопје, 2013, p. 1.

[6] Ана Павловска-Данева, *Имаме Закон, но немаме Управен суд*, Утрински Весник, 29.05.2007.

[7] According to amendment XXVIII of 2005, of the Constitution of Republic of Macedonia of 1991 and according to article 29 of the Law on the Judicial Council of Republic of Macedonia of 2006, it was expected for the new Judicial Council to be constituted before the end of 2006, and in the first months of 2007 the first nomination of judges to commence. The constitutive session of the Judicial Council, took place on 19 December 2006 (when President and deputy President of the Judicial Council were elected); however, the rest of the composition was incomplete because the ruling parliamentary majority because of political divergences did not manage to provide a *Badinter majority* (double parliamentary majority) to elect the remaining other five members of the Council, from which three were nominated by the Assembly of the Republic of Macedonia, and two by the President of Republic of Macedonia. However, because the composition was not complete and the Council function without all members, and they were supposed to elect the judges that will work in the Administrative court, this did not happen and for that reason the foundation of the Administrative court was prolonged.
See: Ана Павловска-Данева, *Судии, обвинители, вентилатори*, Утрински весник, 18.10.2009.

2. LEGAL ISSUES CONCERNING ADMINISTRATIVE JUSTICE IN THE REPUBLIC OF MACEDONIA

The Administrative justice/judiciary in the Republic of Macedonia is not formed to duplicate the Supreme court of the Republic of Macedonia in terms of the jurisdiction/competences and the status that the judges who adjudicate in administrative disputes have. The Administrative court of the Republic of Macedonia was constituted and started to work on 15 December 2007,[8] which marked the start of the practical implementation of the Law on administrative disputes in the legal and social reality. In accordance with the Guide on the handover of cases from the Supreme court of the Republic of Macedonia (Official Gazette of Republic of Macedonia, No. 67/07) the court cases that were registered in the Supreme Court, that had competence to resolve them before the Administrative court was set up, were taken over.[9] Observing from a legal-technical point of view, from the promulgation of the Law on administrative disputes in 2006 up to today, one can notice that the attribute "of Republic of Macedonia" is circumvented in the name of the Administrative court which leaves this important court unfinished. After the words "Administrative court" the predicate (attribute) "of the Republic of Macedonia" is missing (even though, without any doubt, from legal-logical aspect, it is implicitly understood that it the Administrative court of Republic of Macedonia in question). For example like the Supreme court of the Republic of Macedonia, or Constitutional court of the Republic of Macedonia. The territorial jurisdiction of the Administrative court, indisputably is on the entire territory of the country; however, this fact should be reflected in the name of the Administrative court through which its territorial jurisdiction is confirmed.[10] Before the new Law on administrative disputes of 2006 was enacted, the Law on administrative disputes from 1977 of the Socialist Federative Republic of Yugoslavia was in force (Official Gazette of SFRY, No 4/77), in accordance with Article 5 of the Constitutional law to implement the Constitution of the Republic of Macedonia of 1991, and according to which in the Republic of Macedonia (with its constitution as an independent and sovereign state) the previous existing federative legal acts were taken over as being part of the national legislation in accordance with the Constitution of the Republic of Macedonia. According to that, in the tradition and continuity of the constitutional -legal order for the matter of administrative disputes, the judicial control over the legality of the administrative acts in Republic of Macedonia is based on the Constitution of the Socialist Federative Republic of Yugoslavia of 1974 and the aforementioned Federative law on administrative disputes of 1977, to which Republic of Macedonia participated in the adoption and implementation of that law as a sovereign republic in the federative state of Yugoslavia.[11] In that respect, with the new Law on administrative disputes of 2006, approved by the Assembly of the Republic of Macedonia, the legal obligation set in the Constitutional law to implement the Constitution of Republic of Macedonia of 1991[12] was accomplished, even though it was done after 10 years, to harmonize the existing federative laws that were taken over as part of the national legislation in the Constitution of the Republic of Macedonia (as it was the case with the Federative law on administrative disputes of 1977).[13] In accordance with this, the Assembly of the Republic of Macedonia did its

[8] *Закон за изменување и дополнување на Законот за управните спорови*, Скопје, 2010, p. 1
[9] Борче Давитковски, Ана Павловска-Данева, *Анализа на Законот за управните спорови*, Скопје, 2009, p. 2.
[10] Ана Павловкса-Данева, *На Законот за Управите спорови му е потребна ревизија*, Утрински весник, 02.11.2008.
[11] Фиданчо Стоев, *Коментар на Законот за управните спорови*, Скопје, 2006, p. 4.
[12] Уставен Закон за спроведување на Уставот на Република Македонија, Службени лист на Социјалистичка Федеративна Република Југославија, бр. 52/1991.
[13] Фиданчо Стоев, *Проширување и зајакнување на управно-судската заштита преку посебен управен суд*, Судиска Ревија, бр.3-4/2006, Скопје, p. 34.

legislative activity by approving the Laws on courts in 2006 and Law on administrative disputes in 2006, as well as the Law on the changing and supplementing the Law on Courts of Republic of Macedonia of 2010 and the Law on the changing and supplementing the Law on administrative disputes of the Republic of Macedonia of 2010, and through which legal acts the Republic of Macedonia, realistically and practically, set up the basis for administrative justice/judiciary, as specialized judiciary. The Administrative court as a special entity was constituted, with the competence to decide in first instance in administrative disputes over the legality of the acts of the organs of the state administration, Government, other state organs, municipalities and the city of Skopje, organizations with public competences established in law and legal and other persons, when they are deciding on the rights and obligations in individual administrative matters, as well as acts issued in misdemeanor procedure and a Higher administrative court as responsible for appeals over decisions of the Administrative court. From the formation of the Higher administrative court, the Supreme court in administrative disputes decides only on request of extraordinary legal review of administrative judicial decisions of the Higher administrative court, that is to say that it decides over extraordinary legal recourses/remedies against the administrative judicial decision of the Higher administrative court in cases when it is regulated according to the Law on administrative disputes of the Republic of Macedonia.[14]

Arguments to establish a special administrative justice/judiciary were the inefficiency of the previously tasked Supreme court to adjudicate in administrative-legal cases in administrative disputes, beyond reasonable time decision-making over cases in administrative matters, slow and expensive administrative-legal proceedings and etc. In addition to forming a special Administrative court (and following a Higher administrative court) there was a need to have a more narrow specialization of the judges that in some way can better understand the spirit and substance of administrative-legal phenomenon, that is to say to have deeper and more thorough analysis of the core legal institutes in the administrative-legal area.[15] Furthermore, there is no judge that knows all legal domains equally, the same as there is no university professor that knows all legal areas. Every lawyer-judge is not equipped to efficiently handle all legal disputes without knowledge of the legal area in question, for example: for administrative-judicial adjudication it is necessary to have basic legal knowledge and knowledge of administrative law in the specific area, as well as practical experience, conscience for justice and legal certainty, for the overall social climate and action of the legal norms on the social relations,[16] whilst it is not recommended to have judges that have specialized in civil or criminal law to adjudicate in administrative-legal cases.[17] When it comes to the specialization of the courts and judges, undoubtedly, it will create greater professionalization, promptness and improved quality of court decisions. However, a strong meticulous judicial specialization throughout their career as judges is not possible and allowed.[18] Therefore, the establishment of a special Administrative judiciary, on the one side means specialization of courts that will decide on administrative disputes, taking in consideration the specific nature of administrative-legal matter and the specific nature of the administrative-legal dispute – in which state institutions are on the one side, and citizens and

[14] See: Borce Davitkovski, Ana Pavlovska-Daneva, Elena Davitkovska, Dragan Gocevski, *Reform fatigue*, Political thought, br. 48/2014, p. 30; Дејан Витански, *Контрола над администрацијата*, Годишник на Правен Факултет на Универзитет "Св. Климент Охридски", Битола, 2013, p. 48.

[15] Дејан Витански, *Јавна администрација-состојби, проблеми и предизвици*, Скопје, 2012, p. 153-154.

[16] Zoran Tomić, *Komentar Zakona o upravnim sporovima*, Beograd, 2012, p. 66.

[17] *See:* Ана Павловска-Данева, *Врховниот суд и владините управни акти*, Утрински весник, 17.12.2006.

[18] Љупчо Арнаудовски, *Реформа на македонското судство*, Зборник – Зајакнување на независноста и ефикасноста на судството, Хелсиншки комитет за човекови права на Република Македонија, Скопје, 2005, p. 115.

legal persons trying to upheld their rights and legal interests, in relation to acts made by competent state institutions or institutions with public competences, are on the other side. In that respect, the specialization and capacity building of judicial resources to adjudicate in administrative disputes should especially be provided in the framework of judicial education in the Academy for training of judges and public prosecutors of the Republic of Macedonia.[19] All administrative court are divided into administrative courts that have general jurisdiction (e.g. Latvia, Sweden, Luxembourg, Lithuania, Poland, Bulgaria, Macedonia, Croatia, Slovenia, Montenegro, and Albania), that have jurisdiction to control all individual concrete administrative acts, without taking in consideration the administrative-legal area in which they are issued, and administrative courts that have special jurisdiction (e.g. France, Germany, and Austria) that decide on special administrative-legal matter, that is to say in special administrative-legal domains.[20] Seen from the aspect of institutional "architectonic structure" the administrative-legal proceedings, that is to say the Administrative justice/judiciary of Republic of Macedonia is in two instances, and it is made of Administrative court as Court of first instance and Higher administrative court (Administrative court of appeals) as court of second instance. Furthermore, according to its typology the Administrative justice/judiciary in Republic of Macedonia is organized as a separate administrative judiciary with general jurisdiction, that decides on all administrative-legal cases from administrative disputes on national level regardless of their typology, that is to say regardless of their ontological or substantial/content administrative-legal theme, and not as narrowly specialized types of administrative courts (i.e. trade, social, financial etc) that decide on cases from individual or concrete administrative matters.[21][22] The Administrative court and Higher administrative court as specialized courts through the authoritative judicial control over administrative acts should represent a legal guarantee for the rights and legal interests of the citizens to be efficiently met. Administrative and Higher administrative court are founded and have state judicial authority on the entire territory of the Republic of Macedonia. The seats of the Administrative and Higher administrative courts are in Skopje and as such they are central organs of the state judicial power of the Republic of Macedonia. In that context, one should mention that the Law on administrative disputes of the Republic of Macedonia of 2006 inaugurates an European-continental system of administrative-legal protection through establishing the Administrative justice/judiciary as specialized judiciary with competence to decide over administrative disputes. Connected to this fact, it is interesting to underline that the European-continental system of administrative-legal protection in the Republic of Macedonia is a German variant in organizational and functional sense, because the Administrative justice/judiciary is installed as a full fledged independent branch of the judicial system and as such it is an integral component of the state judicial power, and not like in the case of the French variant where the administrative justice/judiciary in organizational and functional sense is transposed in the framework of the state administration; however, in its work in operational/functional sense is completely independent from it. In addition, Administrative justice/judiciary entails mainly the European continent and today represent an European model and form of judicial legal protection of

[19] Фиданчо Стоев, *Проширување и зајакнување на управно-судската заштита преку посебен управен суд*, Судиска Ревија, бр.3-4/2006, Скопје, p. 37-38.
[20] See: Đuro Vuković, *Pravna država*, Zagreb, 2005, p. 228-229.
[21] For example, Germany as a modern democratic rule of law state has a developed system for judicial review of acts of state organs. Beside the general administrative courts, there are narrowly specialized types of administrative courts (firstly, special social courts that resolve disputes from the area of social law, and special financial courts, that review decisions of the state organs from the area of tax law) dedicated to resolving only a certain types of administrative disputes. - See: *Излагања од Управното право и Управното судство*, Скопје, 2011, p. 16.
[22] See: Borče Davitkovski, Ana Pavlovska-Daneva, *Upravni spor u Republici Makedoniji*, Pravni život, Beograd, br. 10/2007, p. 849-855.

citizens' rights and judicial control over the legality of the administrative acts[23] of the state administration.[24] However, the entire mechanism where the administration is its own judge bares the essence of not being objective, being one-sided and with that being not satisfactory. Therefore, the state itself i.e. the public administration, if it evaluates the righteousness of its work, does not have the required distance and neutrality: it will stand by primary, if not exclusively, on the request from the administration and the measures of public interests. In every state, the system of state executive-administrative organs, among other things, implement the adopted policies, and its intertwined with their spirit and ideas – and that stands from the basis to the top of the governing pyramid. Because of that for the organs of the public administration the law is more like a framework than a basic parameter of functioning. The simplest possible expression, is that implementing objective law has the primary goal to satisfy public needs, and after that also to meet individual interests, and to protect individual legal positions.[25] Consequently to the aforementioned, one can draw the conclusion that objective and real control of the legality of individual administrative acts can not be done by the organ that enacts individual administrative acts, but only an organ that is outside from the framework of the state administration, imposed with the request of equitable actions and enacting a rightful and legal decision and taking in consideration the historical experience that nobody is the judge in his own matter (*nemo judex in sua propria causa*), i.e. to avoid the public administration to be the both faces of the medal – to be a judge and a party in the administrative dispute at the same time.[26] Therefore, the public administration cannot have the last word over the rights and obligations of the citizens, that is to say that the administration cannot be judge of its own work. In this context, in administrative-legal proceedings, participating subjects in an administrative legal proceedings are the party and the organ of public administration, between whom the administrative disputes arose. The lawsuit submitted and the bearer of the disputed administrative act are parties in the administrative-legal proceedings. The lawsuit party initial act is to start the administrative-legal proceedings against the final individual administrative act in front of the Administrative justice/judiciary. The plaintiff (the dissatisfied party), is most commonly the one for whose rights, obligations or legal interests were decided in an administrative procedure with a certain administrative act, and he/she is not satisfied with the act – considering that a legal norm was breached to his damage – and requests from the court effective and impartial legal protection. More precisely, the first requirement of the the lawsuit is to avoid illegal actions of the organs of public administration, including their passive acts (i.e. silence of administration) in a concrete case. That task is conferred to court of general jurisdiction (commonly to administrative departments, that are separated from civil or criminal departments), or to – what is more common and dominant contemporary – specialized independent judicial bodies, administrative courts.[27] The sued (public administration, the bearer of the challenged administrative act) in the administrative dispute is the bearer of the administrative act – the state organ, that is to say the institution or legal person that has public competences. Because the administrative dispute is led against the act of organ in second instance, the sued party in the dispute is the organ of second instance. The sued party in the administrative dispute can also be the organ of first instance, but only when an administrative

[23] The administrative act in legal doctrine is defined as a legal (normative), individual, unilateral, binding act of administrative authority deciding on administrative matters. Administrative acts are individual in the sense that they refer to a particular case or cases and their application is limited to that case/s. – Ivo Krbek, *Upravni akt*, 1957, Zagreb, p. 16.

[24] Ibidem.

[25] Zoran Tomić, *Komentar Zakona o upravnim sporovima*, Beograd, 2012, p. 47.

[26] See: Симеон Гелевски, *Судска контрола над управните акти*, Зборник на Правниот Факултет "Јустиниан Први", Скопје, 2010, p. 149; Mirko Perović, *Problemi upravnog spora*, Beograd, 1959, p. 15.

[27] Zoran Tomić, *Upravni spor i upravno sudovanje u savremenoj Srbiji,* Zbornik radova Pravnog fakulteta u Splitu, br.1/2010, p. 23.

dispute cannot be raised directly and immediately against the act of the organ of first instance.[28] The party and the public administration organ in the administrative-judicial procedure have an equal legal status and have certain procedural rights. The essence of case of the administrative-judicial process is made of assessment of the legality of the challenged administrative act. The administrative-judicial process to evaluate the legality of the final individual administrative acts is a legal jurisdiction of the Administrative court of Republic of Macedonia that has a hierarchical rank of national court. In managing and adjudicating in administrative-judicial proceedings in regards to the participating parties the Administrative judiciary should operate as an independent and impartial institutional arbiter (that stands between the administrative state power and the individual) and to issuing a administrative judicial decision that gives a legal closure to a certain concrete case. The administrative judicial decision that supersedes the illegal or wrong individual legal act or requires the state to compensate damages to the citizen in question, does not diminish the efficiency and the reputation of the state administration, but on contrary, an administrative judicial decision like that contributes to improve public administrative activities, to protect public power of the state and create confidence of citizens in state institutions.[29]

Independent and impartial (administrative) justice/judiciary has a special role in affirming the rule of law in the public-legal sphere from a simple reason that judges know best the law and as experienced professionals they apply the positive law into practice. Independent (administrative) judiciary means independence not only in a normative way, but also in factual-real way in regards to other branches of state power, as well as constant and immovable (administrative) judges. Independent (administrative) judiciary means moral courage of (administrative) judges to decide (administrative disputes) between citizens and state administration, based on the applicable law, and not on basis of hate, friendship or pity for any of the parties.[30] In the given context, one should make a difference between two meanings of independence. In relation to this, to paraphrase the theoretical-legal work done by the eminent professor of Constitutional Law Kurtesh Saliu, and to transfer it to administrative justice/judiciary, adapting it to the thematic context of the matter in question of this article, one should make distinction between two meanings of "independence". One meaning, in relation to administrative justice/judiciary, of independence is expressed in the objective situation and legal position of the administrative judiciary as a state judicial institution, and the independence is expression of action, the dynamics of Administrative court decisions. The independence of the administrative justice/judiciary, in this sense, means that it is a special form of a state organ in the regards of the overall organizational structure of the entire judiciary in the Republic Macedonia. On the other hand, the other meaning of independence means to free the judiciary, including administrative judiciary, from external influences, to be free to adjudicate which means that no other part of the government can interfere in the work of the courts. However, the independence of the administrative judiciary also means to have the administrative judiciary legally regulated so that arbitrary decisions and political opportunism are excluded from its work. The point that derives from this argument is that the independence of judiciary is not absolute, but it is independence in a legal framework that is in force because the administrative judiciary is forced to decide on administrative disputes as determined by legal norms, and not on basis of opportunism. In that respect, the independence of the administrative justice/judiciary is a decisive element to accomplish the legality of administrative court proceedings. The trials are legal if the decisions of the administrative justice/judiciary are in accordance with the legal norms. There

[28] Ivan Matović, *Upravni postupak 2*, Zagreb, 1998, p. 159.
[29] Dario Đerđa, *Pravci reforme institucionalnog ustroja upravnog sudstva u Republici Hrvatskoj Zbornik radova Pravnog fakulteta u Splitu*, br. 1/2008, p. 77.
[30] See: Светомир Шкарић, Гордана Силјановска-Давкова, *Уставно право*, Скопје, 2009, p. 321-322.

cannot be legality without a law. Beside that, for the independence of the administrative justice/judiciary, the independence of the administrative judges has a special meaning because the aim is to ensure their impartiality in performance of judicial functions. Therefore, the legal guarantees for independence of the judges are many, starting from how they are elected, their professionalism, their salaries, the time interval for which they are elected and the security of the administrative judges in performing their functions and their protection from the executive state power that may punish the "non-obedient" judge by transferring him or dismissing him ahead of time etc. As a consequence, the dilemmas over of all these issues are regulated in a special international normative-legal document: the European Charter on the status of the judges.[31] Therefore, the European standards in regards to questions about judges' status, for example: their material status and their rights and responsibilities in a condensed way are systematized in the European Charter on the status of the judges which was adopted in the Multilateral Conference of the judges in Strasbourg in 1998.[32] The independent legal position of the administrative judiciary in constellation of divisions of power, yields the question about the responsibility of the independent administrative justice/judiciary. As with any other public function, the administrative-judicial function needs to be under certain institutional control, because without any control and responsibility, it can be twisted and transformed (as the history of judiciary shows) into a corrupt function of distributing "selective and private administrative justice" of the judge or to adjudicate under influence of the government or influential parties in the administrative-legal proceedings.[33] Contrary to that, the application of the law has to be non-selective and transparent, on behalf from the Administrative justice/judiciary that should not be under political influence and should act without selection and privileges for anyone. Furthermore, rule of law requires objective law to be implemented, and especially the implementation of the Constitution and laws as objective legal acts. The subjective understanding and interpretation (the opinion of the judge himself) of the law, and especially the selective implementation, in the final instance, leads to negation of the law. The law will have sense and meaning if and only if it is realized as an objective legal norm and if there is an objective legal action.[34] The delicate position and responsibilities of judges in the Administrative court in action as *Legislatorum est viva vox, rebus et non verbis, legem imponere* - The voice of legislators is a living voice, to impose laws on things and not on words / the mere mouthpiece of the law" / "the mouth that pronounces the law" can not be anything else but objective providers of judicial duties in order to protect the rights and legal interests of the subjects of the law, and of course in administrative-legal field and also in the objective lawfulness as "servants of the law" – *juris est lege servi*.[35] The administrative-judicial proceedings is a system of legally prescribed process actions of the administrative judge and the parties in the case, that the administrative judges initiates upon an administrative lawsuit as the initial act to start the procedure against the final individual administrative act of one party. It is important to note that the

[31] Kurtesh Saliu, *E drejta kushtetuese*, Prishtinë, 2004, p. 107-108.
[32] Владо Камбовски, *Судско право*, Скопје, 2010, p. 199-200; *European Charter on the statute of the judges*, Council of Europe, Strasbourg, 1998, p. 3-19.
[33] Because of that, the function of control over the work of the court in the Constitution of Republic of Macedonia in 1991 and the Law on the courts of Republic of Macedonia in 2006 is focused on the Judicial Council of Republic of Macedonia that is an independent and impartial judicial organ, that ensures and guarantees the independence and impartiality of judiciary, by doing its functions in accordance with the Constitution and the law – Amendment XXVIII of the Constitution of Republic of Macedonia of 1991; Article 2 of the Law on the Judicial Council of Republic of Macedonia, Official Gazette, No. 60/06.
[34] See: *Pravni leksikon*, Zagreb, 2007, p. 1190-1194; Marta Vidaković Mukić, *Opći pravni rječnik*, Zagreb, 2006, p. 850.
[35] See: Arsen Bačić, Petar Bačić, *Ustavna demokracija i sudovi*, Split, 2009, p. 36; Šarl Monteskje, *O duhu zakona I*, Beograd, 1989, p. 183.

administrative judge cannot ever start on his own an administrative-judicial proceedings *ex-officio*. The reason is that the administrative-judicial proceedings in front of the Administrative court, as a rule, is based on the principal *ne procedat iudex ex officio* – judges shall not proceed on their own, but only after a lawsuit (*ex-privato*) of the authorized subject (party maxim)[36] if he considers that the administrative act breaches some of his rights or indirect legal interest based on law – a subjective administrative dispute. In a subjective administrative dispute, according to the rule, the subjects that initiate the legal dispute are individuals and legal entities, as the name of such disputes suggest. However, there is an objective administrative dispute that can be initiated by the Public Attorney of the Republic of Macedonia, in accordance with his competences, if an administrative act or administrative contract breaches the law or public interest, that is to say the institution that he represents according to the law. Furthermore, the Administrative justice/judiciary deals with the essence of administrative-legal disputes with a court decision, and thereby determining whether the contested act is illegal or not, and depending on that whether to annul the act or not. The court decision, according to the rule, represents the only legal way to have fair resolution of specific administrative disputes, and that means a restriction to interfere to all state organs in the administrative-judicial process and in the administrative-judicial decision: the administrative judicial decision of Administrative judiciary acts like a sanction with annulling legal action (*ex tunc*) for the final illegal administrative act of the state administration. The state organ that is sued can appeal the administrative-judicial decision in first instance of the Administrative court of the Republic of Macedonia in front of the Higher administrative court of the Republic of Macedonia. On the other hand, only the Supreme court can decide on the final court decision of the Higher administrative court in cases of extraordinary legal remedies.[37] The final court decision has inviolable legal action, and is mandatory for all natural and legal persons and has a greater legal force in comparison to other decisions of any other organ and everyone has to respect the final and executive court decision under threat of legal sanctions.[38] Therefore, the status of the final administrative judicial decisions of the Administrative judiciary (Higher administrative court of Republic of Macedonia) as adjudicated affairs – *res iudicata,*[39] have the legal force of a law for the concrete case of the administrative dispute settlement and at the same time is mandatory, and by rule have to be executed in practice.[40] In that context, the Law on the Courts of Republic of Macedonia of 2006 in general prohibits any actions that prevents not only the decision making of the court but also the implementation of the court decision.[41] At the same time, every state organ has the obligation, meaning the one that has competences to act, to ensure the implementation of the court decision, and the court is in charge of supervision according to the law.[42]

[36] The mentioned rule is also labelled with the sentence *nemo iudex sine actore* – when there is no complainant there is no judge, that is a synonymous with the accusatory principle and the start of procedure.

[37] See: Кирил Чавдар, Кимо Чавдар, *Коментар на Законот за управните спорови*, Скопје, 2013, p. 335, 365, 405-406.

[38] Article 13, *Law on the Courts of Republic of Macedonia,* Official Gazette of Republic of Macedonia, No. 58/2006.

[39] The court's decision is final and cannot be reviewed if it concerns the same matter, the same legal grounds and the same parties. This prevents the matter from being heard by the court again as a *res judicata*.

[40] Slavoljub Popović, *Upravni spor u teoriji i praksi*, Beograd, 1968, p. 342-345; articles 52 & 53, *Law on administrative disputes of the Republic of Macedonia* – Official Gazette of Republic of Macedonia, No. 62/2006; Article 13, *Law on the Courts of Republic of Macedonia,* Official Gazette of Republic of Macedonia, No. 58/2006.

[41] Article 14, *Law on the Courts of Republic of Macedonia,* Official Gazette of Republic of Macedonia, No. 58/2006.

[42] Article 15, *Law on the Courts of Republic of Macedonia,* Official Gazette of Republic of Macedonia, No. 58/2006.

Implementation of final and executive court decision is done in the fastest and most efficient way possible and can not be obstructed with a decision of any other state organ.[43] After the final court decision is implemented and the concrete administrative-legal dispute is resolved, then the legal norm was applied and justice was served. The primary aim of the administrative-judicial protection of administrative acts is to provide legal protection from voluntary and arbitrary state administration, and that protection is ensured with starting an administrative dispute in front of the responsible judiciary (administrative judiciary or ordinary judiciary) that varies from one state to the other. Introducing the administrative dispute as legal institution, one protects the legality of administrative acts that were enacted by organs of state administration, local self-government, and organizations, and acts in misdemeanor proceedings.[44] In that way, the administrative justice/judiciary is a special qualified and competent state judicial organ, that can effectively judge the legal dimensions of administrative duties, that is to say the legality of administrative acts.[45] Having that in mind, administrative justice/judiciary in its own *ratio iuris* – legal reason and usage is a state judicial institution for legal protection of the individual and his individual legal sphere, his subjective public rights[46] from being breached by state administration in performing their administrative-legal tasks. Furthermore, an indirect intermediate product of the administrative justice/judiciary is to ensure the objective legal order, that is to say the public administration to act according to the legal rules so that it applies same measures e.g. equal actions in similar cases, or with one word to ensure equitable public administration.[47] This means that public administration is only "a new name for an old job", for equitable public administration. Also, it is a relevant fact that judicial control over administrative actions by one administrative judiciary, that functions well, is one stimulative force to modernize public administration, to improve the quality of their services and as a consequence to increase the confidence of citizens in state institutions. The reason for this is the fact that the administrative judiciary plays a special role in building and improving the rule of law. Through this judiciary the state provides to the citizens an instrument to question the actions of the state. Therefore, the Administrative justice/judiciary represent institutions that ensure freedom for the citizens. For the state they represent an instrument to control the quality of work of the administrative authorities of the state and other institutions that have public competences. This is the main reason to have request for administrative judges to be competent, professional and independent.[48] In the most general senses, that is adopted in the administrative-legal theory, the Administrative judiciary represents an especially specialized judiciary that does administrative-judicial control and valorisation of legality of final individual administrative acts that the public administration enacts when dealing with administrative disputes among subjects of the law and the administrative state power, to exercise and protect subjective

[43] Article 16, *Law on the Courts of Republic of Macedonia*, Official Gazette of Republic of Macedonia, No. 58/2006.
[44] Slavojlub Popović, Branislav Marković, Radovan Hrnjaz, Rajko Kuzmanović, *Osnovi nauke o upravljanju*, Beograd, 1984, p. 369.
[45] Симеон Гелевски, *Судска контрола над управните акти*, Зборник на Правниот Факултет "Јустиниан Први", Скопје, 2010, p. 149.
[46] Lazo Kostic speaks about the difference between rights and interests. Subjective right is explained as"interest inherent to one subject and legally protected according to his will". The right or interest do not have to be of legal property nature. Kostic mentions the Italian concept according to which the interest should be "assessable". It has to be individual interest, based on law – that comes out from some objective legal norm – legitimate for the personal interest (and not "diffused" that leads to *actio popularis*) and in a way that is direct, meaning present and imminent. - See: Lazo Kostić, *Administrativno pravo Kraljevine* Jugoslavije-Treća knjiga, Beograd, 1939, p. 96-97.
[47] See: Stevan Sagadin, *Upravno sudstvo*, Beograd, 1940, p. 83
[48] *Излагања од Управното право и Управното судство*, Скопје, 2011, p. 9.

public rights and legal interests of the parties based on laws for administrative-legal relations that contribute to strengthening the objective legality in the domain of administrative activities of a certain state.[49] From a formal and organizational point of view, the Administrative justice/judiciary presents a completely innovative segment in the judicial composition of the Republic of Macedonia, that represent a specialized court instance that should guarantee legal certainty and certainty of decision-making in administrative matters[50] i.e. in all administrative-legal areas. However, from a material and functional point of view, the Administrative justice/judiciary is not a new legal category, more precisely the administrative dispute as regular and systematic form of judicial control over the legality of administrative acts of the administrative state power in the Republic of Macedonia is not a new form of judicial-legal disputes in the legal system of the Republic of Macedonia, from a sole reason that it dates back to 1952, and there is judicial practice and legal tradition of more than 50 (fifty) years.[51]

3. CONCLUDING REMARKS

The formation of the Administrative justice/judiciary in the Republic of Macedonia can be analyzed in three ways: *first*, and foremost it is in the interests, of the citizens because it allows for resolution of administrative-legal disputes against decisions made by the state, or more precisely the state administration, that is to say it allows legal protection of human rights when they are breached by the public administration; *second*, it is in the interests of the Supreme court of the Republic of Macedonia because it help to decrease the burden of numerous administrative-legal cases from the area of administrative-legal disputes; and lastly, *third*, it is in the interests of the Government of the Republic of Macedonia as the effective titular (bearer) of state executive power because the practice of this court will be the best and most objective barometer and indicator about the level or degree of legality and efficiency in the work of the public administration in Republic of Macedonia. The most frequent argument in favor of the formation of special administrative justice/judiciary is the fact that the administrative matter is dynamic according to its content nature, and it requires specialization of the judicial resources to have control over the implementation of the matter in practice. Also, one should point out that if administrative matter is uncodified, then its implementation in practice becomes more complicated, and therefore it is necessary to have special court resources that will be able to fully follow legal regulations which apply to the work of the government and the scope of their application.

LITERATURE:

1. Арнаудовски, Љупчо, *Реформа на македонското судство*, Зборник – Зајакнување на независноста и ефикасноста на судството, Хелсиншки комитет за човекови права на Република Македонија, Скопје, 2005;
2. Bačić, Arsen; Bačić, Petar, *Ustavna demokracija i sudovi*, Split, 2009;
3. Чавдар, Кирил; Чавдар, Кимо, *Коментар на Законот за управните спорови*, Скопје, 2013;

[49] This formulation caries the substrate of the definition given in the Legal lexicon of Republic of Croatia in 2007, that which the author of this article created and enriched in its dimension of its content. - See: *Pravni leksikon*, Zagreb, 2007, p. 1697.

[50] Administrative matter is a legal, individual, non-contentious situation in which the administrative authority is entitled to and obliged by the law to decide on a right, duty or legal interest of an individual or an organization. - Зоран Јелић, *У трагању за идентитетом управне ствари*, Правни живот, бр. 9/1996, p. 691.

[51] See: Симеон Гелевски, *Управен спор и Управно судство во Република Македонија*, Деловно право - *Списание* за теорија и практика на правото, Скопје, бр. 15/2006, p. 171-177.

4. Davitkovski, Borče; Pavlovska-Daneva, Ana, *Upravni spor u Republici Makedoniji*, Pravni život, Beograd, br. 10/2007
5. Давитковски, Борче; Павловска-Данева Ана, *Анализа на Законот за управните спорови*, Скопје, 2009;
6. Davitkovski, Borce; Pavlovska-Daneva, Ana; Davitkovska, Elena; Gocevski, Dragan, *Reform fatigue*, Political thought, br. 48/2014
7. Đerđa, Dario, *Pravci reforme institucionalnog ustroja upravnog sudstva u Republici Hrvatskoj*, Zbornik radova Pravnog fakulteta u Splitu, br. 1/2008;
8. Јелић, Зоран, *У трагању за идентитетом управне ствари*, Правни живот, бр. 9/1996;
9. Гелевски, Симеон, *Управен спор и Управно судство во Република Македонија*, Деловно право - Списание за теорија и практика на правото, Скопје, бр. 15/2006;
10. Гелевски, Симеон, *Судска контрола над управните акти*, Зборник на Правниот Факултет "Јустиниан Први", Скопје, 2010;
11. Kostić, Lazo, *Administrativno pravo Kraljevine Jugoslavije*-Treća knjiga, Beograd, 1939;
12. Koprić, Ivan, *Upravno sudovanje u svjetlu prilagodbe standardima EU-a*, Reforma upravnog sudstva i upravnog postupanja, Zagreb, 2006;
13. Камбовски, Владо, *Судско право*, Скопје, 2010;
14. Matović, Ivan, *Upravni postupak 2*, Zagreb, 1998;
15. Marković, Branislav; Hrnjaz, Radovan; Kuzmanović, Rajko, *Osnovi nauke o upravljanju*, Beograd, 1984;
16. Monteskje, Šarl, *O duhu zakona I*, Beograd, 1989;
17. Радовановић, Љубомир , *О административном судству*, Архив за правне и друштвене науке, бр. 1/1922;
18. Sagadin, Stevan, *Upravno sudstvo*, Beograd, 1940;
19. Saliu, Kurtesh, *E drejta kushtetuese*, Prishtinë, 2004;
20. Секулић, Љубомир, *Основи управног права*, Подгорица, 2004;
21. Стоев, Фиданчо, *Коментар на Законот за управните спорови*, Скопје, 2006;
22. Стоев, Фиданчо, *Проширување и зајакнување на управно-судската заштита преку посебен управен суд*, Судиска Ревија, бр.3-4/2006, Скопје;
23. *Pravni leksikon*, Zagreb, 2007
24. Perović, Mirko, *Problemi upravnog spora*, Beograd, 1959;
25. Popović, Slavoljub, *Upravni spor u teoriji i praksi*, Beograd, 1968;
26. Шкарић, Светомир; Силјановска-Давкова, Гордана, *Уставно право*, Скопје, 2009;
27. Tomić, Zoran, *Komentar Zakona o upravnim sporovima*, Beograd, 2012;
28. Tomić, Zoran, *Upravni spor i upravno sudovanje u savremenoj Srbiji*, Zbornik radova Pravnog fakulteta u Splitu, br.1/2010;
29. Vuković, Đuro, *Pravna država*, Zagreb, 2005;
30. Vidaković Mukić, Marta, *Opći pravni rječnik*, Zagreb, 2006.

Legal resources

1. Закон за управните спорови на Република Македонија, Службен Весник на Република Македонија, бр. 62/2006;
2. Закон за судовите на Република Македонија, Службен Весник на Република Македонија, бр. 58/2006;
3. Закон за изменување и дополнување на Законот за судовите, Службен Весник на Република Македонија, бр. 150/2010;

4. Закон за изменување и дополнување на Законот за управните спорови на Република Македонија, Службен Весник на Република Македонија, бр. 150/2010;
5. Устав на Република Македонија со амандманите на Уставот I - XXXII Скопје, 2011;
6. *European Charter on the statute of the judges*, Council of Europe, Strasbourg, 1998.

CRIMINAL LIABILITY OF MEDICAL DOCTORS *DE LEGE LATA* AND CRIMINAL LAW CHALLENGES *DE LEGE FERENDA*

Branko Brkic
Constitutional Court of the Republic of Croatia, Zagreb, Croatia
Branko_Brkic@usud.hr

Ive Brkic
Law Office, Zadar, Croatia
ivebrkic@yahoo.com

ABSTRACT

The legislator has only formally raised the human and noble activity of doctors to the rank of an activity of special social interest. However, at the same time, the legislator has imposed on medical activity numerous regulatory threats as well as criminal, misdemeanor, disciplinary and compensation liability. Therefore, the real question is in what way special social interest is reflected. Doctors work every day in the unnatural great fear of error which far exceeds that of any other occupation. This paper provides an overview of the criminal liability of doctors for malpractice and for failure to provide medical assistance in the Republic of Croatia at the legal and doctrinal level. The paper shows comparative solutions in various other legal systems, provides a critical review of existing law, and finally presents some ideas de lege ferenda *that could be acceptable not only in Croatia but in other countries. Each individual doctor is required to respect Article 1 of the Code of Medical Ethics and Deontology, which obliges every doctor to engage in continuous professional development, to respect the patient's right to full information about their condition, so patients can give valid consent for the chosen method of medical treatment, and to respect the dignity of the patient in general, paying at the same time attention to their own dignity. Since medical activity is of special public interest, doctors as performers of medical activity are also persons of special social significance. Consequently, society needs to protect them from legal harassment. The authors of this paper believe that by changing the Criminal Code in the sense of reducing criminal legal enforcement and possibly by enforcing compulsory insurance against the risk of incorrect treatment, doctors would be relieved of the unnecessary fear of making a mistake.*

Keywords: *criminal liability, doctor, malpractice, healthcare*

1. INTRODUCTION

The Constitution of the Republic of Croatia[1] provides in Article 58 that everyone is guaranteed the right to healthcare in conformity with law, which means that the health of the nation has been raised to the level of a constitutional value. On the other hand, the activity of doctors is an activity of special social interest and serves the same goal – the right of the patient to healthcare. However, the doctor and the patient are sometimes in conflict in terms of the quality of medical services rendered and of the potential compensatory liability or even criminal liability of the doctor. One should bear in mind that the right to work and the freedom of work are also values protected by the Constitution (Article 54.1), which means that doctors have the right to perform their activity freely and without fear, which further means that it is essential to strike a fair balance between the rights of patients and the rights of doctors. At the first international symposium, organised by the Croatian Medical Chamber, the Croatian Chamber of Health Professionals, and the Faculty of Law in Split in 2015, some

[1] Official Gazette Nos. 41/01. – *revised text*, 55/01., 76/10., 85/10. and 5/14.

of the participants pointed out that "the state of human health is an issue *par excellence* in any social community... The partnership and contractual relations of doctors and patients must not mean, however, that their roles in the treatment process are wholly, and mechanically, equalised (50:50). The role of the doctor must be, and must remain, dominant ...".[2]

Legal and medical science are in a constant state of flux and the legislator has a social obligation in the creation of *medical law*, by using scientific research methods, taking into account the methods of the history of law, comparative law, and statistics, to create a legal framework for the unhindered and free performance of the medical profession that will release health professionals[3] from fear in the course of the performance of their noble and responsible profession, since fear leads to insecurity, and insecurity results in error.

In this paper, we present only such segments of criminal law that are significant for health professionals who may be subject to criminal liability in the performance of medical activity, so that they might adjust their professional training and their approach to the patient in a way to avoid such a type of liability. This is even more important if one considers that criminal liability, when it is established by a final decision, may lead to liability for damages,[4] which may go in pair with disciplinary liability[5] and, sometimes, even with misdemeanour liability. Yet another unavoidable consequence is also moral liability and social defamation of the doctor. We posit that such an accumulation of liabilities is too great a burden for the doctor, since he may find himself under the *sword of Damocles, even if he has acted in good faith. This should be avoided at all costs.*

We can generally agree with those who say that *"... treatment... which includes invasive procedures on the human body is intertwined with the risk against the life or health of the patient, and if such procedures are performed improperly they may result in the gravest of consequences for the health and life of the patient. That is precisely why criminal law enforcement (and not only moral, disciplinary or civil liability) is a legitimate mechanism for ensuring the quality of healthcare services. ... However, only in cases of wilful misconduct and gross negligence".* [6]

It is well-known that in terms of the criminal liability of doctors (and other persons engaged in medical activity), there are two basic criminal law systems. In one approach (e.g., German criminal law), there are no special criminal offences for health professionals since they are liable for general incrimination arising from criminal law (e.g., they may be held accountable for murder, negligent homicide, and intentional or negligent infliction of physical injury), while other criminal law systems foresee the special criminal offence of malpractice (unconscientious treatment) and other offences against the health of human beings, which are the *delicta propria* of health professionals. Croatian criminal law accepts the latter system,

[2] Radolović, A., *Pravo na život, zdravlje, dostojanstvo i privatnost (prava osobnosti) kao temelji građanskog medicinskog prava,* Collection of Papers from the International Symposium "Medical Law in the Healthcare System", Plitvice, 13-14 November 2015, Faculty of Law in Split, pp. 103-122.

[3] This term will include doctors, health workers, and health assistants, since all of them are engaged in medical activity.

[4] See, inter alia, Klarić, A., Cvitković, M., *Vrste i načini odgovornosti unutar tima*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11-13 November 2016, Faculty of Law in Split, p. 215ff.

[5] For more, see Veselić, I., *Disciplinska odgovornost zdravstvenih radnika s pregledom sudske prakse*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11-13 November 2016, Faculty of Law in Split, pp. 193ff.

[6] Also Kurtović Mišić, A., *Osnove kaznenopravne odgovornosti zdravstvenih radnika,* Collection of Papers from the International Symposium "Medical Law in the Healthcare System", Plitvice, 13-14 November 2015, Faculty of Law in Split, pp. 193ff.

which is more onerous as far as doctors are concerned, as we shall attempt to show in this paper.

Pursuant to Article 24 of the Healthcare Act[7], medical activity is an activity of interest for the Republic of Croatia... performed by healthcare professionals in rendering medical aid.

Pursuant to Article 2 of the Medical Profession Act[8], **a doctor** is the **main and relevant provider of medical activity**. Criminal offences that are the subject matter of this paper may be committed only through the unconscientious or unprofessional performance of medical activity or the refusal to render medical aid.

In this paper we shall limit our examination of the matter to the legal terms and concepts that are essential to understand the topic. In the prescription of criminal offences, it is essential to be restrictive because, according to the principle of subsidiarity of criminal law and criminal law enforcement, prescribed in Article 1 of the Criminal Code[9] "... criminal offences and criminal law sanctions shall be prescribed only for acts threatening or violating personal freedoms and human rights and other rights and social values guaranteed and protected by the Constitution of the Republic of Croatia and international law to the extent that their protection could not be achieved without criminal law enforcement ...".

Guilt is the subjective relationship between the perpetrator and the act, opening the perpetrator to the possibility of a reprimand. A reprimand may be issued against a perpetrator who decided not to follow the law, although, in view of his characteristics and the circumstances of the case, the perpetrator could have abided by it. There is no criminal offence without guilt.

In short, a criminal offence may be defined as unlawful misconduct (an act or an omission) that meets the legal characteristics of the criminal offence in question, provided that there are no reasons for the exclusion of unlawfulness.

2. LEGAL REGULATION OF CRIMINAL OFFENCES AGAINST THE HEALTH OF PEOPLE AS *DELICTA PROPRIA*[10]

2.1. Introduction

In our examination of the criminal offences in question we relied on the information that *"... in case law, malpractice and failure to render urgent medical aid are the most prevalent criminal offences committed by health professionals, ... that almost two thirds of all criminal charges are dismissed by the competent state attorney office as unfounded, that injured parties assume criminal prosecution following dismissal of the charges in only one-third of the cases and, in the case of convicting judgments, conditional sentences (80%) and fines are the most prevalent, which shows that the practice of criminal courts towards health professionals is very 'benevolent'... Cases of deliberate injuries inflicted on the patient are very rare in case law and, in practical terms, health professionals are held liable exclusively for negligence (culpa). What is disputable is whether this is gross negligence or ordinary negligence..."*.[11]

Is this not sufficient indication for the legislator that something has to be changed in the concept of law because it is clear that the state attorney office has justified reasons to be "benevolent" towards the errors of doctors, but so do courts in the opening of investigations and in sentencing?

[7] Official Gazette Nos. 150/08., 71/10., 139/10., 22/11., 84/11., 154/11., 12/12., 35/12. - DCCRC, 70/12., 144/12., 82/13. - hereinafter: Healthcare Act

[8] Official Gazette Nos. 121/03. and 117/08.

[9] Official Gazette Nos. 125/11., 144/12., 56/15., 61/15. – hereinafter: CC/11.

[10] *Delicta propria* means criminal offences that can be committed only by persons who hold a certain capacity; in this case, health professionals.

[11] Op. cit. (n 6) p. 4.

2.2. Malpractice

Malpractice is sanctioned in Article 181 CC/11. It follows from the text of the law that for a criminal offence to have been committed a **manifestly unsuitable means or a manifestly unsuitable manner of treatment** should have been used, ie, any means or manner of treatment that **manifestly deviates from the standards and rules of medical science**. Manifestly unconscientious treatment in the provision of health services includes manifest superficiality, manifest negligence, manifest hastiness and any manifestly unconscientious procedure in the performance of medical activity. Not all instances of superficiality, negligence or hastiness or all deviations from the rules of the profession are a criminal offence.

The criterion for differentiation is the care of an average doctor and an average health professional or associate, ie, the care of a good expert, because we hold that in the Republic of Croatia the level of medical training of doctors and health professionals is very high and that an average doctor is a good doctor, and that we should not use as a benchmark an expert with above average levels of education.

Our position is also confirmed in the decision of the Supreme Court of the Republic of Croatia no. IV Kž-244/2002-3 of 26 June 2003, according to which "*... in terms of criminal law, liability exists only in cases of conduct that manifestly deviate from the rules of the profession and science, and of conduct that is unconscientious in general, that negligence is generally determined by the criterion of the standard of care of a reasonably prudent provider, and that no one is required to have extraordinary abilities. Therefore, an incorrect assessment in serious cases such as, indubitably, this one, does not constitute liability for negligence in terms of criminal law...".*

It is evident from the legal description of the criminal offence concerned that it can be committed by wilful misconduct or as a result of negligence. Pursuant to Article 28.2 CC/11, the perpetrator acts with direct intent (Latin: *dolus directus*) when he is aware of the characteristics of the criminal offence and seeks or is sure of achieving these characteristics[12]. It is hard to imagine that a health professional would commit a criminal offence with direct intent[13] because, in doing so, he would commit a wholly different criminal offence, eg, murder or the infliction of serious physical injury. Besides, does not the name of the incrimination "malpractice" indicate indifference, inadvertence, negligence, and recklessness, and none of them is characteristic of actions with direct intent? Pursuant to the provision of Article 28.3 CC/11, the perpetrator acts with indirect intent (Latin: *dolus indirectus*) when he is aware that the characteristics of a criminal offence (in this case, malpractice) may be realised, and accedes to it. Were it not for the doctrinally disputable construct of *intent to harm and intent to endanger*[14] (that, in relation to malpractice, there must be indirect intent and, in terms of the consequences for the health of the patient, that negligence suffices), it would be difficult to imagine a case of malpractice that could be subsumed under direct or indirect intent as a form of guilt. This is why *de lege ferenda* we hold that conduct with intent (direct or indirect) should be omitted from the law. We would not be an exception in this because, as we have already mentioned, German (or Austrian) criminal law does not include such separate criminal offences. In terms of negligence in the criminal offence of

[12] See also Novoselec, P., Bojanić, I., *Opći dio kaznenog prava*, Faculty of Law, University of Zagreb, Zagreb, 2013, p. 238.

[13] Some consider it possible and provide examples (Kurtović Mišić, A., Sokanović, L., *Namjera kao stupanj krivnje u počinjenju kaznenih djela zdravstvenih radnika*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11-13 November 2016, Faculty of Law in Split, pp. 128ff).

[14] Novoselec, P., Bojanić, I., op. cit. (n 12) p. 245, hold that this matter involves "substantial theoretical and practical difficulties ..."

malpractice, we find certain doctrinal controversies. Pursuant to Article 29.2 CC/11, the perpetrator acts with advertent negligence (Latin: *luxuria*, which means indulgence, excess) when he is aware that the characteristics of a criminal offence might be realised, but he recklessly assumes that it will not occur or that he will be able to prevent it from occurring. Therefore, recklessness is a basic quality of action with advertent negligence; *the perpetrator believes that the offence is possible, but does not seek to commit it*[15].

Pursuant to Article 29.3 CC/11, the perpetrator acts with inadvertent negligence (Latin: *negligentia* – negligence, carelessness) when he is not aware that the characteristics of a criminal offence can be realised, although, under the circumstances and based on his personal characteristics, he should and could have been aware of the possibility.

It is scientifically necessary to ask whether the liability of doctors (and other medical workers) for malpractice *de lege ferenda* can be restated in a way to narrow the area of criminal liability in favour of civil law liability.

The right to life is guaranteed in Article 2.1 of the Convention for the Protection of Human Rights and Fundamental Freedoms[16]. The right to life includes the right to the protection of one's physical integrity, which also means the right to protection against any deliberate threat or damage to health. The right to life is also guaranteed in the Constitution of the Republic of Croatia (Article 21 of the Constitution). The criminal legislation of the Republic of Croatia is right to prescribe criminal liability for negligent homicide, since death terminates a person's right to life. If we start from the principle of the subsidiarity of criminal law (criminal law enters where civil, disciplinary or misdemeanour law do not provide sufficient protection), the question arises whether doctors should also be subject to criminal liability for negligent homicide, in particular whether they should be liable for inadvertent negligence, the subjective components of which were itemised earlier. Should a doctor who is guided by his desire to help a sick person in an emergency or in any other case, in a situation where he is not aware that the method or procedure used could endanger the health or life of the patient – but should be aware based on his personal characteristics – be subject to criminal liability? In the case of malpractice, there is no intellectual or wilful component of guilt either from the aspect of threat to health or its consequence. Therefore, it would be difficult to justify the conclusion that the doctor should be held liable for inadvertent negligence. The doctor is obligated to provide medical assistance not only when on duty, during working hours, but always and everywhere, without delay, where there is danger to the health and life of a person because, if he does not, he is committing the criminal offence of failure to render medical aid, which is prescribed in Article 183 CC/11. The question arises about why his act is unlawful. He was obligated to provide assistance and he did so; therefore, he did not act *contra legem*.

The possibility of decriminalising medical negligence is evident from the position of the European Court of Human Rights in the Grand Chamber judgment in the case of *Vo v. France* (2004), which reads: *"... if the infringement of the right to life or to physical integrity is not caused intentionally, the positive obligation imposed by Article 2 to set up an effective judicial system does not necessarily require the provision of a criminal-law remedy in every case. In the specific sphere of medical negligence, 'the obligation may for instance also be satisfied if the legal system affords victims a remedy in the civil courts, either alone or in conjunction with a remedy in the criminal courts, enabling any liability of the doctors concerned to be established and any appropriate civil redress, such as an order for damages and for the publication of the decision, to be obtained. Disciplinary measures may also be envisaged...'"*[17]**.**

[15] Pavlović, Š., *Kazneni zakon*, Libertin, Rijeka, 2012, p. 58.
[16] Official Gazette – International Treaties No. 6/99.
[17] See Omejec, J., Konvencija za zaštitu ljudskih prava i temeljnih sloboda u praksi Europskog suda za ljudska prava, Novi informator, Zagreb, 2014, p. 465.

The legislator of the Republic of Croatia opted for a wide scope of sanctions for health professionals. With such a wide prescription of possibilities for the sanctioning of health professionals, with the great activism of associations that are engaged in the protection of patients' rights, and the agility of patients, or their relatives, in the realisation of the right to compensation, there is danger (in the opinion of the authors of this paper) that doctors might became afraid to perform their profession, although it is a profession that should be without fear in its performance, because fear endangers freedom to work and the right to work. If we accept the thesis that doctors should be subject to criminal liability only for advertent negligence, which can be equated, in relation to the terms used, with gross negligence (we mentioned that gross negligence is a term characteristic of civil compensation law), then we would significantly narrow down the sphere of the liability of doctors. There are significant reasons to fully exclude criminal prosecution for negligence because, ultimately, patients must also bear the risk of imperfections ingrained in the healthcare system, and in the medical materials and equipment used in treatment, and they have access to the right to indemnification in civil law proceedings both from the institution in which they were treated through the application of the wrong means and methods, and from the insurer against the risk of incorrect treatment and, subsidiarily, even from the doctor (only if he acted with wilful misconduct or gross negligence). Criminal liability is insufficient satisfaction for an injured party if it is not accompanied by material compensation, but this does not apply the other way around: material satisfaction in the event of medical negligence is sufficient compensation for the patient and there is no need to seek criminal law retribution as a form of revenge against the doctor.

The provision on malpractice should be re-examined even in the existing system of punishment in terms of the amount of fine, because it is absurd that according to Article 181.8 in conjunction with Article 181.4 CC/11 the legislator prescribes imprisonment for the duration of one to eight years for negligent homicide in the provision of medical services, while Article 113 prescribes imprisonment for the duration of six months to five years for negligent homicide in all other cases, not taking into account that the doctor, in the provision of medical care, is guided by humane reasons and by his legal obligation to provide assistance to the patient, whereas other types of negligent homicide are not the result of humane motives, quite the contrary.

2.3. Other criminal offences by health professionals

Considering that malpractice is the most frequent criminal offence under this topic, we shall merely mention others: illicit removal and transplantation of parts of the human body (Article 182 CC/11), failure to render urgent medical aid (Article 183 CC/11), and carelessness in the preparation and dispensing of drugs (Article 187 CC/11).

3. COMPARATIVE DISPLAY OF CRIMINAL LIABILITY OF DOCTORS

3.1. Germany

The criminal legislation of the Federal Republic of Germany does not have a separate sanction for the negligent medical treatment or the lack (refusal) of medical assistance, and such eventual conduct of doctors and health workers is generally punishable by the incrimination of the criminal offenses of murder, or the commission of serious bodily injury or serious damage to health when providing medical help, as a criminal act that can be committed as act of the offender, or for lack (refusal) of medical assistance as a criminal act that can be committed by omission, as a failure to act.

3.2. Austria[18]

Similarly to the criminal law of the Federal Republic of Germany, Austria does not have a separate sanction for the negligent treatment or the lack (refusal) of medical assistance, and such possible behavior of doctors and health workers is generally punishable through criminal offenses of murder, or the commission of serious bodily injury or serious damage to health when providing medical help, as a criminal act that can be committed as act of the offender, or for lack (refusal) of medical assistance as a criminal act that can only be committed by omission, as a failure to act[19].

3.3. England and Wales

England and Wales do not have a separate criminal offense of the negligent medical treatment or the lack (refusal) of medical assistance, and such possible behavior of doctors and health workers resulting in the death of a patient falls under the criminal offense of "Manslaughter". The criminal offense of "Manslaughter" has different features from the criminal offense of causing death by neglect in Croatian legislation, so it cannot be adapted or compared to the criminal offense of causing death by neglect in Croatian legislation by its name or scope, although under the name Manslaughter is also included the criminal offense of causing death from neglect in England and Wales.

"Manslaughter is an offence of unlawful killing, or homicide. It is distinguished from murder by finding the absence of 'malice aforethought', roughly translated as an intention to kill. Manslaughter covers the majority of homicides that are not murder. A charge of manslaughter allows for the court to have discretion in punishment, ranging from an absolute discharge to life imprisonment. This discretion reflects the commensurately wide range of circumstances that could have lead to the unlawful killing. This is necessary, since some defendants who did have an intention to kill can nevertheless establish that this intention was mitigated by one of three main defences; diminished responsibility, a loss of self-control via provocation, or engagement in a suicide pact. In these special circumstances, of voluntary manslaughter, mitigation may allow a reduction in the sentence to make it proportionate to their crime. No such mitigation is available in murder, since for this the life sentence of imprisonment is mandatory"[20].

The doctor from the aspect of responsibility for the negligent medical treatment resulting in death of the patient may be responsible for involuntary manslaughter and unintentional gross negligence manslaughter.
In all cases that ended with the conviction of the defendant the court has required the following elements to be proven in the conviction of a doctor for involuntary manslaughter, related to the alleged unlawful killing of a patient:
- That the defendant has neglected his duty to care for the patient
- That such negligence resulted in the death of the patient
- That negligence goes beyond ordinary negligence and is "gross" negligence[21].

The judgment of whether the conduct of doctor it is an infallible medical error or a criminal offense depends on the court's conclusion whether the defendant's conduct with regard to the

[18] Network source: justline. At; Accessed April 2, 2017.
[19] § 95 StGB Osterreich Unterlassung der Hilfeleistung (Omission of the assistance)
[20] Wheeler, R., director of department of clinical law, "Manslaughter by doctors" http://www.uhs.nhs.uk/HealthProfessionals/Clinical-law-updates/Manslaughter-by-doctors.aspx
[21] Ibidem

circumstances of the medical case and the risk to the patient is so obviously wrong and bad that he deserves a criminal proceeding, and criminal punishment.

This test[22] of the doctor's responsibility for the criminal offense of unintentional murder with gross negligence was set by Lord Mackay LC in the House of Lords R v Adomako [1994] 3 WLR 288 judgment and today presents a precedent and valid test in determining whether a doctor's conduct that lead to the death of a patient, is ordinary medical error or criminal offense.

In the R v Adomako[23] (1994) case, the defendant was an anesthesiologist in charge of the patient during the course of the eye surgery. During the operation, the oxygen supply tube was separated from the patient and the patient died. The jury ruled that the defendant had failed to notice and react to the obvious signs that the oxygen pipe had been separated and declared him guilty of the gross negligence manslaughter's criminal offense. The Appellate Court dismissed the appellant's appeal, but sent a question to House of Lords: "In cases of manslaughter by criminal negligence not involving driving but involving a breach of duty is it a sufficient direction to the jury to adopt the gross negligence test set out by the Court of Appeal in the present case following R. v. Bateman (1925) 19 Cr. App. R. 8 and Andrews v. Director of Public Prosecutions [1937] A.C. 576, without reference to the test of recklessness as defined in R. v. Lawrence (Stephen) [1982] A.C. 510 or as adapted to the circumstances of the case?"

House of Lords answered: "In cases of manslaughter by criminal negligence involving a breach of duty, it is a sufficient direction to the jury to adopt the gross negligence test set out by the Court of Appeal in the present case following R. v. Bateman 19 Cr. App. R. 8 and Andrews v. Director of Public Prosecutions [1937] A.C. 576 and that it is not necessary to refer to the definition of recklessness in R. v. Lawrence [1982] A.C.510, although it is perfectly open to the trial judge to use the word "reckless" in its ordinary meaning as part of his exposition of the law if he deems it appropriate in the circumstances of the particular case".

3.4. Slovenia

The provision on negligent medical treatment in Slovenia[24] does not prescribe special punishment for neglect, obviously holding that the criminal offense of negligent medical treatment cannot be committed with the direct intent, what is also thesis that we advocate for.

[22] R v Adomako [1994] 3 WLR 288 House of Lords:
Lord Mackay LC set the test for gross negligence manslaughter:
"On this basis in my opinion the ordinary principles of the law of negligence apply to ascertain whether or not the defendant has been in breach of a duty of care towards the victim who has died. If such breach of duty is established the next question is whether that breach of duty caused the death of the victim. If so, the jury must go on to consider whether that breach of duty should be characterised as gross negligence and therefore as a crime. This will depend on the seriousness of the breach of duty committed by the defendant in all the circumstances in which the defendant was placed when it occurred. The jury will have to consider whether the extent to which the defendant's conduct departed from the proper standard of care incumbent upon him, involving as it must have done a risk of death to the patient, was such that it should be judged criminal.
The essence of the matter which is supremely a jury question is whether having regard to the risk of death involved, the conduct of the defendant was so bad in all the circumstances as to amount in their judgment to a criminal act or omission...
It is true that to a certain extent this involves an element of circularity, but in this branch of the law I do not believe that is fatal to its being correct as a test of how far conduct must depart from accepted standards to be characterised as criminal. This is necessarily a question of degree and an attempt to specify that degree more closely is I think likely to achieve only a spurious precision."

[23] R V Adomako [1995] 1 AC 171

[24] Article. 179. of the Criminal Code of the Republic of Slovenia (Official Gazette 50/2012)

If someone has direct intension and wants to commit the murder of a patient through medical treatment, it cannot be criminal act of negligent medical treatment, but classic case of murder.

3.5. Montenegro

Criminal acts against human health in the Republic of Montenegro in the sphere of our scientific consideration are regulated in a similar way as in the Republic of Croatia, obviously following the legal tradition of the former common state. Similar legislation also has the Republic of Serbia.

4. CONCLUSION

It is evident that the criminal liability of doctors is regulated in a number of comparative ways that are different, and sometimes diametrically opposed. In our opinion, the legislator should be quite clear in stating that the criminal offence of malpractice cannot be committed intentionally, and that the area of punishment should include only malpractice resulting from advertent negligence but not inadvertent negligence, because in that case the doctor would be subject to liability for insufficient knowledge, or insufficient expertise in the performance of a particular medical procedure.

The authors of this paper hold that with such an intervention in the criminal legislation the Republic of Croatia would meet the requirement regarding a decrease in criminal law enforcement and, along with compulsory insurance against the risks of malpractice, which is already regulated by law, the providers of medical services would be free from unnecessary fear of error and the patient would be provided with the right to compensation of damages as satisfaction for incorrect treatment. We are convinced that we have sufficient arguments to claim that any doctor who acts in good faith should not bear either criminal or compensatory liability for any errors he might commit, or any other type of liability (misdemeanour or disciplinary).

LITERATURE:

1. Bagić, S. (2016). *Informirani pristanak u sudskoj praksi*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split
2. Cerjan, S. (2016). *Radnopravna odgovornost zdravstvenog radnika prema poslodavcu*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split
3. Criminal Code of the Republic of Croatia (Official Gazette 125/11., 144/12., 56/15., 61/15.)
4. Criminal Code of the Republic of Slovenia (Official Gazette 50/12)
5. Criminal Procedure Act (Official Gazette 152/08., 76/09., 80/11., 121/11., 91/12., 143/12., 56/13., 145/13., 152/14.)
6. Healthcare Act (Official Gazette 150/08., 71/10., 139/10., 22/11., 84/11., 154/11., 12/12., 35/12., 70/12., 144/12., 82/13., 159/13., 22/14., 154/14.)
7. https://www.jusline.at/, accessed April 2, 2017.
8. Klarić A., Cvitković, M. (2016). *Vrste i načini odgovornosti unutar tima*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split
9. Korošec, D. (2016). *Slovensko medicinsko kazensko pravo v primerjalnopravni perspektivi*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split

10. Kurtović Mišić, A. (2015). *Osnove kaznenopravne odgovornosti zdravstvenih radnika*, Collection of Papers from the International Symposium "Medical Law in the Healthcare System", Plitvice, 13.-14. November 2015., Faculty of Law in Split
11. Kurtović Mišić, A., Sokanović, L. (2016). *Namjera kao stupanj krivnje u počinjenju kaznenih djela zdravstvenih radnika*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split
12. Medical Proffesion Act (Official Gazette 121/03., 117/08.)
13. Muzur, A., Rinčić, I. (2016). *Obaviješteni pristanak u Hrvatskoj danas, bioetički i sociološki aspekt*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split
14. Novoselec, P., Bojanić, I. (2013). *Opći dio kaznenog prava*, Faculty of Law, University of Zagreb, Zagreb
15. Omejec, J. (2014). *Konvencija za zaštitu ljudskih prava i temeljnih sloboda u praksi Europskog suda za ljudska prava*, Novi informator, Zagreb
16. Pavlović, Š. (2012). *Kazneni zakon*, Libertin, Rijeka
17. Primorac, D. (2015). *Pravni aspekt vještačenja tjelesnih ozljeda u kaznenom postupku s posebnim osvrtom na sudsku praksu*, Collection of Papers from the International Symposium "Medical Law in the Healthcare System", Plitvice, 13.-14. November 2015., Faculty of Law in Split
18. Radolović, A. (2015). *Pravo na život, zdravlje, dostojanstvo i privatnost (prava osobnosti) kao temelji građanskog medicinskog prava*, Collection of Papers from the International Symposium "Medical Law in the Healthcare System", Plitvice, 13.-14. November 2015., Faculty of Law in Split
19. The Constitution of the Republic of Croatia (Official Gazette 41/01. – revised text, 55/01., 76/10., 85/10., 5/14.)
20. The Convention for the Protection of Human Rights and Fundamental Freedoms (Official Gazette – International Treaties No. 6/99.)
21. Veselić, I. (2016). *Disciplinska odgovornost zdravstvenih radnika s pregledom sudske prakse*, Collection of Papers from the International Symposium "The 2nd Croatian Symposium of Medical Law", Vodice, 11.-13. November 2016., Faculty of Law in Split
22. Wheeler, R., director of department of clinical law, "Manslaguhter by doctors" http://www.uhs.nhs.uk/HealthProfessionals/Clinical-law-updates/Manslaughter-by-doctors.aspx, accessed April 2, 2017.

CROSS-BORDER TRADE AND CONSUMER PROTECTION

Barbara Bosner
County Court of Rijeka, Croatia
bosnerbarbara@gmail.com

ABSTRACT

Consumer protection in cross-border trade is an important part of EU Private International Law. Special rules aimed at protecting consumers are included in the Brussels Ibis Regulation and the Rome I Regulation. Furthermore, the specific rules of jurisdiction over consumer contracts are contained in Section 4 of the Brussels Ibis Regulation (Arts. 17-19) while Art. 6 of the Rome I Regulation comprises the respective choice of law rules. The rules of jurisdiction over consumer contracts contained in Arts. 17-19 of the Brussels Ibis Regulation presuppose the existence of an international or cross-border element. Art. 17 determines the scope of application of the provisions on jurisdiction over consumer contracts, which excludes the application of the general rules, e.g. Arts. 4, 7 and 8. Furthermore, Art. 18 defines the criteria on which the court shall base its jurisdiction to hear consumer disputes, both in cases where claims are brought by the consumer and where claims are brought against the consumer. The last paragraph sets out a rule for a counter-claim. Finally, Art. 19 prescribes the conditions for the valid conclusion of the choice-of-court agreement, additional to general conditions in Art. 25. In addition to the conditions which have to be fulfilled for a consumer contract to qualify for protection under Art. 6 Rome I Regulation, there are also exceptions provided for certain types of contracts. In cases falling under the scope of Article 6 protection, the consumer and professional are allowed to choose the law applicable to their contract, to the extent that the consumer is not deprived of the protection granted by mandatory rules of law which would otherwise be applicable, i.e. the law of the country where the consumer has his habitual residence. The aim of this paper is to update legal practitioners on EU consumer protection legislation in cross-border trade for the purpose of its effective implementation in practice, especially in view of the EU Court of Justice case law interpreting these provisions.

Keywords*: choice of law, consumer contracts, consumer protection, European Union, jurisdiction*

1. INTRODUCTION

The system of consumer protection is primarily based on the premise that a consumer is the weaker contracting party with regard to both bargaining power and level of knowledge. One of the fundamental goals of EU Private International Law is to improve the consumer`s position in the internal market, with implications for the consumer, in particular, and society, in general. Therefore, the aim of this paper is to update legal practitioners on EU consumer protection legislation in cross-border trade for the purpose of its effective implementation in practice, especially in view of EU Court of Justice case law interpreting these provisions.

The consumer protection regime under the Brussels Ibis Regulation is based on a long legal tradition in the EU and presupposes the existence of a cross-border element. The 1968 Brussels Convention introduced consumer protection as an important part of EU Private International Law and it was a basis for the Brussels I Regulation adopted on 22 December 2000. In order to improve the application of certain Brussels I Regulation provisions, the Brussels Ibis Regulation was adopted on 12 December 2012 and has been applied since 10 January 2015. Moreover, in the case of consumers, the provisions of the Rome I Regulation of 17 June 2008 follow the concept of the previous Rome Convention (1980).

In addition, this paper presents the specific rules of jurisdiction over consumer contracts contained in Section 4 of the Brussels Ibis Regulation (Arts 17-19) and the choice of law rules defined in Art. 6 of the Rome I Regulation. Consequently, Chapters 2 to 4 of the paper are concerned with Arts.17-19 of the Brussels Ibis Regulation. Namely, Chapter two analyzes the scope of application of the provisions on jurisdiction over consumer contracts contained in Art. 17 and Chapter 3 is concerned with Art. 18 regulating jurisdiction in consumer contracts covered by Art. 17 while Chapter 4 addresses the issue of permissible jurisdiction clauses (Art. 19). Furthermore, Chapter 5 is focused on cases falling under the scope of Art. 6 of the Rome I Regulation.

In conclusion, emphasis is placed on the role of ECJ case law regarding the implementation of the consumer protection provisions in question and the amendments of the Brussels I Regulation in relation to consumer protection.

2. THE SCOPE OF CONSUMER PROCEDURAL PROTECTION IN CROSS-BORDER DISPUTES (Art. 17 Brussels Ibis Regulation)

The scope of application of the provisions on jurisdiction in consumer contracts is laid down in Article 17 of the Brussels Ibis Regulation. Article 17(1) provides that in matters relating to a contract concluded by a person, the consumer, for a purpose which can be regarded as being outside his trade or profession, jurisdiction shall be determined by Section 4, without prejudice to Article 6 and point 5 of Article 7, if: a) it is a contract for sale of goods on instalment credit terms; or b) it is a contract for a loan repayable by instalments, or for any other form of credit, made to finance the sale of goods; or c) in all other cases, the contract has been concluded with a person who pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State or to several States including that Member State, and the contract falls within the scope of such activities. According to Art. 17(2) where a consumer enters into a contract with a party who is not domiciled in a Member State but has a branch, agency or other establishment in one of the Member States, that party shall, in disputes arising out of the operations of the branch, agency or establishment, be deemed to be domiciled in that Member State. Art. 17(3) prescribes that Section 4 shall not apply to a contract of transport other than a contract which, for an inclusive price, provides for a combination of travel and accommodation.

In general, Article 17 provides the conditions for the application of Section 4 Brussels Ibis Regulation. First, this Section applies only to the consumer contracts listed in Art. 17 (1). Accordingly, there are three categories of contracts: a) sale of goods on instalment credit terms, b) credit contracts financing sale of goods and c) all other contracts provided that the professional directs his activities to the Member State of the consumer`s domicile. Next, Art. 17 (2) prescribes a rule for contracts concluded by a consumer with a party not domiciled in a Member State but with establishment in a Member State, while Art. 17 (3) excludes from the scope of this Section contracts of transport apart from a package travel arrangements.

Bearing in mind that the basic requirement for the application of Art. 17(1) is the existence of a contract (BGH MDR 2014, 918 [10]; referenced by Magnus, Mankowski, 2016, p.458), the ECJ interpreted the concept of a contract within the meaning of this provision in Gabriel, Engler and Ilsinger.

In Gabriel (C-96/00, Gabriel, 2002, ECR I-6367), the facts of the case in short indicated that an Austrian consumer received several letters in person from a German company, creating the impression that a prize would be awarded upon ordering a certain amount of goods. The

consumer ordered the goods, but did not receive the prize. Therefore, the consumer brought proceedings in Austria according to Art. 14(1) Brussels Convention (Art. 18(1) Brussels Ibis Regulation) and the Austrian court submitted the question to the ECJ for a preliminary ruling. The ECJ held that the parties were linked to each other by contract within the meaning of Art. 13 (1) (3) Brussels Convention (Art. 17 (1) (a) Brussels Ibis Regulation), since the consumer concluded the contract for the sale of goods essentially, if not exclusively, by reason of the seller`s promise of financial benefit significantly greater than the minimal amount required for the order. Consequently, the ECJ concluded that the consumer`s claim was contractual in nature and the court in Austria was competent to deal with the claim seeking the prize since it had jurisdiction to deal with the consumer contract in question.

The question of whether a consumer is entitled to procedural protection under Art. 13 Brussels Convention (Art. 17 Brussels Ibis Regulation) was also examined in Engler (C-27/02, Engler, 2005, ECR I-499). In this case, an Austrian national received a letter in person at her domicile in Austria from a German mail order company. The letter contained a "payment notice" that led her to believe that she had won a prize of money in a "cash prize draw" organized by the German company and a catalogue of goods marketed by the German company with a request for a trial without obligation. The payment notice contained instructions to sign it and return it to the German company. The Austrian complied with the instructions, believing that was sufficient to obtain the prize but the German company refused to pay it. Thus, the Austrian claimed the prize before an Austrian court. As to the question if the claim constitutes a claim in contract under the Brussels Convention, the ECJ found that in this case the claim did not fall within the scope of Article 13 because the award of the prize allegedly won by the Austrian consumer was not subject to the condition that she order goods from the German company and no order was placed. On the other hand, the ECJ held that the claim was covered by Article 5(1) Brussels Convention.

There is an opinion that the ECJ took a broad approach in Ilsinger (C-180/06, Ilsinger, 2009, ECR I-3961) where it held that the scope of Article 15(1) (c) Brussels I Regulation (Art. 17 (1) (c) Brussels Ibis Regulation) is no longer limited to those situations in which parties assumed reciprocal obligations (Van Calster, 2013, p.70). In this case, similar to the previous ones, an Austrian national received a letter addressed to her personally from a German mail-order company. The message in the letter gave the impression that she had won a certain prize and the next day she tore-off the coupon containing the identification number and returned it attached to the "prize claim certificate" to the German company as requested. The Austrian national further stated that she had placed a trial order at the same time, while the German company claimed that no order of goods was placed. Yet, it is common ground that the award of the prize supposedly won by the Austrian national did not depend on such an order. Since the Austrian national had not received payment of the prize, she brought an action before the Austrian court for that purpose. The ECJ held that Art 15(1)(c) cannot apply to legal proceedings such as those at issue in the main proceedings if the professional vendor did not undertake contractually to pay the prize promised to the consumer who requests its payment. In that case, Article 15(1)(c) is applicable to such legal proceedings only on condition that the misleading prize notification was followed by the conclusion of a contract, i.e. if the consumer had in fact placed an order with that professional vendor.

As previously mentioned, the contract contemplated by Art.17 (1) must be a consumer contract, which is a contract concluded by a person for a purpose that can be regarded as being outside his trade or profession. According to ECJ case-law, the concept of a consumer, who is evidently a natural person, is a uniform concept and the definition given in Art. 17(1) is influenced by ECJ`s judgement in Société Bertrand v. Paul Ott KG (C-150/77, Société

Bertrand, 1978, ECR I-431; referenced by Magnus, Mankowski, 2016, p.463). Furthermore, in Gruber (C-464/01, Gruber, 2005, ECR I-439), the ECJ had to examine the question of dual purpose contracts. This is the case when a person concludes a contract for purposes which are in part within and in part outside his trade or profession. Regarding the question of whether that person may invoke protection under the special rules of jurisdiction laid down in Articles 13 to 15 of the 1968 Brussels Convention (Articles 17-19 of the Brussels Ibis Regulation), the ECJ stated that the person seeking the protection has to prove that a business use of purchase is insignificant.

Regarding the contracts referred to in Art. 17(1) (c), it should be noted that 1(c) is not restricted to sale of goods since it applies to all types of contracts, with the exception of insurance contracts (Section 3) and contracts covered by Section 6 of the Brussels Ibis Regulation. This provision was drafted for the purpose of e-commerce but there is a critical opinion that it seems to provide little in the way of real guidance which results in uncertainty for E-tailers (Van Calster, 2013, p. 67). On the other hand, some authors argue that Art. 17 (1) (c) has contributed to the continuous growth of e-commerce in Europe (Magnus, Mankowski, 2016, p.482). Also, the ECJ in the Joined Cases Pammer and Alpenhof (Joined Cases C-585/08 and C-144/09, Pammer and Alpenhof, 2010, ECR I-12527) outlined a number of criteria for the application of the provision in an Internet context. Particularly, the problem may arise where it must be determined whether marketing activities on the Internet are directed towards the consumer`s country. The ECJ held that mere accessibility is not sufficient and that it should be ascertained whether the professional was envisaging doing business with consumers in the Member State in question, taking into account, for example, the use of the top-level domain name, language, and currency of the country of the consumer. In conclusion, it is apparent that the concept of directing activities may be applied to all kinds and modes of technology employed (Mankowski, 2009; referenced by Magnus, Mankowski, 2016, p.484) and it is for courts to adapt it to the particular circumstances of a case.

3. RULES ON JURISDICTION RELATING TO CONSUMER CONTRACTS (Art. 18 Brussels Ibis Regulation)

The relevant provision on jurisdiction in consumer contracts is contained in Art. 18 Brussels Ibis Regulation. Article 18 (1) provides that a consumer may bring proceedings against the other party to a contract, either in the courts of the Member State in which that party is domiciled or, regardless of the domicile of the other party, in the courts of the place where the consumer is domiciled. According to Art. 18 (2) proceedings may be brought against a consumer by the other party to the contract only in the courts of the Member State in which the consumer is domiciled. Article 18 (3) provides that this provision shall not affect the right to bring a counter-claim in the court in which, in accordance with this Section, the original claim is pending.

Thus, consumers have a choice of forum, while proceedings against consumers may only be brought in the courts of the Member State in which the consumer is domiciled**.** The domicile for a consumer and the other party, when it is a natural person, is determined in accordance with Art. 62 Brussels Ibis Regulation but if the other party is a company, or other legal person or association, the domicile is determined in Art. 63. Furthermore, as previously mentioned, according to Art. 17(2), when a professional has no domicile in any Member State, but merely a branch, agency or other establishment in one of the Member States, it will be deemed to be domiciled in that Member State. The major change in Art. 18 (1) Brussels Ibis Regulation contains a rule on jurisdiction in disputes against professionals domiciled outside the European Union.

This new extended jurisdiction upon third countries defendants is, with no doubt, in favor of the protection of consumers, as stated in Recital 14 par. 2 of the Brussels Ibis Regulation. However, some authors argue that this new regulatory scheme enhances consumer protection but may be unattractive for business outside the EU (Harris, 2014, p. 709,712; referenced by Magnus, Mankowski, 2016, p.511).

In practice, consumers initiate proceedings before courts of their domicile due to lower costs, native language, etc. Still, a problem may arise if, after the conclusion of a contract, the consumer moves to another Member State. In this case, when the consumer institutes proceedings and the contract falls within Art. 17 (1) (a) or (b), the consumer has a right to choose between the old and new Member State (Report Schlosser, para.161; referenced by Magnus, Mankowski, 2016, p.512). Further, in cases covered by Art. 17 (1) (c), there is an opinion that the consumer should have the right to choose between the old and the new Member State if a professional pursues commercial or professional activities in both states and the contract falls within the scope of these activities in both states (Magnus, Mankowski, 2016, p.512). Yet, there are opinions that the new domicile matters since it is the current domicile at the time of filing a lawsuit (Keiler, Binder, 2013, p. 230,236, referenced by Magnus, Mankowski, 2016, p.512).

Taking into account the protective character of Section 4, in the case when a claim is brought against a consumer, his new domicile is relevant for jurisdiction (Report Jenard, p. 33, referenced by Magnus, Mankowski, 2016, p.513). Also, when the court is unable to ascertain the consumer`s domicile, the ECJ in Hypotečni banka a.s. vs. Udo Mike Lindner (C-327/10, Hypotečni banka a.s., 2011, ECR I-11543) held that the courts of the Member State in which the consumer had his last known domicile have jurisdiction to deal with proceedings in the case, provided that there is no firm evidence that the defendant is domiciled outside the European Union.

Finally, Art. 18 (3) prescribes a rule for a counter–claim and is an exception to para. 1 and 2 since the court in which the original claim is pending has jurisdiction to deal with both cases.

4. PROROGATION AGREEMENTS IN CONSUMER LAW DISPUTES (Art. 19 Brussels Ibis Regulation)

Article 19 defines the conditions for the valid conclusion of a choice-of-court agreement related to consumer contracts. According to Art. 19, the provisions of Section 4 may be departed from only by an agreement: (1) which is entered into after the dispute has arisen; (2) which allows the consumer to bring proceedings in courts other than those indicated in this Section; or (3) which is entered into by the consumer and the other party to the contract, both of whom are at the time of conclusion of the contract domiciled or habitually resident in the same Member State, and which confers jurisdiction on the courts of that Member State, provided that such an agreement is not contrary to the law of that Member State.

The provision sets out special rules on the validity of prorogation agreements in disputes involving consumers, while general conditions for a valid conclusion of a choice-of court agreement are prescribed in Art. 25 and these provisions should be read together. In practice, this means that an agreement on jurisdiction should be in writing. The list contained in Article 19 is exhaustive in order to protect consumer`s procedural rights under Art. 18 (Magnus, Mankowski, 2016, p.517).

According to Art. 19 (1), a prorogation agreement relating to a consumer contract is valid if it has been entered into after the dispute has arisen. Thus, in practice, parties to the contract may not conclude a valid agreement on jurisdiction before a dispute has arisen and no

jurisdictional clause or standard term contained in the contract prior to the dispute is acceptable. This rule is supported by the argument that the consumer is only at this stage capable of understanding the effect of an agreement on jurisdiction (Geimer, 2010, p. 348, referenced by Meškić, 2015, p. 771). Also, the parties are allowed to confer jurisdiction to courts other than those indicated in Section 4, according to Art 19 (2). Here, a jurisdiction agreement may be concluded prior to a dispute, but there are opinions that such jurisdiction is not exclusive and serves as an additional option to jurisdiction under Art.18 (Anoveros Terradas, 2003, p.136, referenced by Van Calster, 2013, p.72). Consequently, the consumer cannot rely on a jurisdiction clause to dismiss proceedings instituted by the other party before the courts of a consumer`s domicile in accordance with Art. 18(2) (Magnus, Mankowski, 2016, p.524). Finally, according to Art. 19 (3), the parties are allowed to agree on jurisdiction if they are both domiciled in the same Member State at the time of the conclusion of the contract and jurisdiction is conferred to a domestic court. This provision seems to be in favor of the other party, since the fact that the consumer has moved to another Member State after the conclusion of the contract does not affect the jurisdiction of a domestic court at the time of conclusion of the contract, provided that such an agreement is not contrary to the law of that Member State.

In conclusion, it is worth mentioning, with regard to the Unfair Contract Terms Directive, that there are opinions that agreements on jurisdiction under this Section should meet the conditions of the Directive by virtue of Art. 67 of the Brussels I Regulation, since the Directive covers all consumer contracts and, ultimately, the jurisdiction agreement under Art. 19 may not be binding under the Unfair Contract Terms Directive (Magnus, Mankowski, 2016, p. 517; Van Calster, 2013, p. 73).

5. CONSUMER CONTRACT PROTECTION (Art. 6 Rome I Regulation)

Article 6 of the Rome I Regulation deals with consumer contracts. Article 6 (1) provides that without prejudice to Articles 5 and 7, 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) shall be governed by the law of the country where the consumer has his habitual residence, provided that the professional: (a) pursues his commercial or professional activities in the country where the consumer has his habitual residence, or (b) by any means, directs such activities to that country or to several countries including that country, and that the contract falls within the scope of such activities. Article 6 (2) prescribes that, notwithstanding paragraph 1, the parties may choose the law applicable to a contract which fulfils the requirements of paragraph 1, in accordance with Article 3. 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 on the basis of paragraph 1. Article 6 (3) provides that if the requirements in points (a) or (b) of paragraph 1 are not fulfilled, the law applicable to a contract between a consumer and a professional shall be determined pursuant to Articles 3 and 4. According to Art. 6 (4), paragraphs 1 and 2 shall not apply to: (a) 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; (b) a contract of carriage other than a contract relating to package travel within the meaning of Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (15); (c) a contract relating to a right in rem in immovable property or a tenancy of immovable property other than a contract relating to the right to use immovable properties on a timeshare basis within the meaning of Directive 94/47/EC; (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; (e) a contract concluded within the type of system falling within the scope of Article 4(1)(h).

The scope of consumer contract protection is defined in Art. 6 of the Rome I Regulation. Article 6 (1) provides that in the absence of parties' choice, the applicable law to a consumer contract will be the law of the country where the consumer has his habitual residence. This rule applies to all consumer contracts, apart from contracts listed in Art. 6 (4). Evidently, the first condition for the application of Article 6 is that a contract has been concluded. In this respect, it should be mentioned that Recital 7 of the Rome I Regulation outlines that the substantive scope and the provisions of this Regulation should be consistent with the Brussels I Regulation. Consequently, the ECJ`s case law on Article 15 Brussels I Regulation (Art. 17 Brussels Ibis Regulation) should also be an interpretative guidance for the application of Art. 6 (McParland, 2015, p.506), in particular regarding the prize cases (Gabriel, Engler and Ilsinger). Further, Art. 6 (1) determines the concept of a consumer and the other party. The consumer is, clearly, a natural person who acts outside his trade or profession, and for that reason he may invoke protection under Art. 6. Regarding the question of how to operate the criteria, we should investigate the ECJ`s case-law, for example Gruber (C-464/01, Gruber, 2005, ECR I-439) in the case of dual purpose contracts, or Benincasa (C-269/95, Benincasa, 1997, ECR I-3767) regarding future business purposes where the ECJ held that a consumer should conclude a contract outside and independent of any trade or professional purpose whether present or future. Next, the other party is a person, natural or legal, acting in the exercise of his trade or profession (the professional). In order to qualify for special protection under this provision, the professional has to pursue his commercial or professional activities in the country where the consumer has his habitual residence, or direct such activities to that country or to several countries including that country, and the contract must fall within the scope of such activities. The first option of pursuing professional activities suggests some physical presence in the consumer`s country (Callies, 2011, p.142, referenced by McParland, 2015, p.539). On the other hand, the concept of directing activities to the consumer's state does not require a business's physical presence in that state. In fact, this provision has been adopted from Art. 15 (1)(c) Brussels I Regulation (Art. 17 (1) (c) and it should be interpreted in the same way (McParland, 2015, p.540), taking into account the ECJ`s case-law, especially regarding the Internet context. Also, Recital 24 specifies that consistency with the Brussels Ibis Regulation requires both that there be a reference to the concept of directed activity as a condition for applying the consumer protection rule and that the concept be interpreted harmoniously in both Regulations. The main point here is that, according to Art. 6(2), parties to a consumer contract may choose the law applying to their contract. Hence, party autonomy is permitted for consumer contracts that meet the criteria under Art. 6 (1), but the choice may not have the result of depriving the consumer of the mandatory protection afforded to him by law of the country of his habitual residence. Under the Rome I Regulation, such a choice must be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case, and the parties may subject their contract to any law. The provision of Art. 6, among Arts. 5, 7 and 8, provides specific conflict rules aimed to protect the weaker party and to ensure predictability (Van Calster,2015, p. 134). Therefore, it should be mentioned that the new Directive on consumer rights in Recital 10 states that it should be without prejudice to the Rome I Regulation, meaning that it does not interfere with the applicable law rules laid down by the Rome I Regulation (Van Calster, 2015, p.135).

6. CONCLUSION

The leading principle in EU legislation regarding consumer contracts is to protect the consumer`s rights, since the consumer is considered the weaker contracting party. Specific rules aimed to protect consumers are contained in Section 4 of the Brussels Ibis Regulation in relation to the protection of procedural consumer rights, and the Rome I Regulation comprises the respective choice of law rules in Art. 6. Furthermore, as shown in the paper, the case law of the ECJ offers useful guidelines in interpreting relevant provisions of both the Brussels Ibis Regulation and Rome I Regulation. The decisions and the legal reasoning of the ECJ have shown that the interests of protecting consumers` rights prevail over the interests of commercial parties. Also, in order to provide a higher degree of protection, the Brussels Ibis Regulation contains a new provision in Art 18(1) on jurisdiction in disputes against professionals domiciled outside the European Union. In conclusion, this paper analyses the relevant consumer protection provisions, with the aim of facilitating their implementation in practice in view of the EU Court of Justice case law interpreting these provisions.

LITERATURE:

1. Case C-96/00, Gabriel, 2002, ECR I-6367
2. Case C-27/02, Engler, 2005, ECR I-499
3. Case C-180/06, Ilsinger, 2009, ECR I-3961
4. Case C-150/77, Société Bertrand, 1978, ECR I-431
5. Case C-464/01, Gruber, 2005, ECR I-439
6. Case C-327/10, Hypotečni banka a.s., 2011, ECR I-11543
7. Case C-269/95, Benincasa, 1997, ECR I-3767)
8. Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. Retrieved 01.04.2017. from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0013:en:HTML
9. 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 (Text with EEA relevance) Retrieved 01.04.2017. from http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32011L0083
10. Joined Cases C-585/08 and C-144/09, Pammer and Alpenhof, 2010, ECR I-12527
11. Magnus, U., Mankowski, P. (2016). *European Commentaries on Private International Law ECPIL*. Ottoschmidt
12. McParland, M. (2015). *The Rome I Regulation on the Law Applicable to Contractual Obligations.* Oxford: University Press
13. Meškić, Z. (2015). Novine u procesnopravnoj zaštiti potrošača u prekograničnim sporovima u Evropskoj uniji. Retrieved 01.03.2017. from http://www.prafak.ni.ac.rs/files/zbornik/sadrzaj/zbornici/z70/43z70.pdf. , p. 767-783
14. 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 (recast). Retrieved 01.03.2017. from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:351:0001:0032:en:PDF
15. 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). Retrieved 01.03.2017. from http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32008R0593
16. Van Calster, G. (2013). *European Private International Law*. Oxford, Portland, Oregon: Hart Publishing

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

[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 Rigts ("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).

changed more than 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 procces 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 memebers), which could and had

[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).

to be evident already during the vote, in terms of 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 Act[8] 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 see the enemy in the investors (and in that case they clearly set against all

[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] Emphasited by the author.

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 enviroment. 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 obstructon 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.

CROATIAN LABOUR MARKET DEVELOPMENT PERSPECTIVES IN THE CONTEXT OF FLEXICURITY

Andrijana Bilic
Faculty of Law University of Split
Domovinskog rata 8, 21 000 Split, Croatia
andrijana.bilic@pravst.hr

Trpimir Perkusic
Faculty of Law University of Split
Domovinskog rata 8, 21 000 Split, Croatia
trpimir.perkusic@pravst.hr

ABSTRACT

Already in the period of accession negotiations for entry into the European Union the Republic of Croatia began a wide reform of labour and social security legislation with the aim of its harmonisation with Acquis Communitaire. This was a period in which the Croatian labour market was marked by a large rate of unemployment, segmentation, underdevelopment, low rate of workforce mobility, horizontal and vertical gender segregation and also, by strict employment protection legislation, weak functioning of labour market institutions and poorly developed social dialogue. Exit from such a situation was attempted to be found in flexicurity, a concept which the European Commission strongly promoted. Its implementation is achieved through flexible and reliable contractual arrangements and work organisations, an active labour market policy, a system of reliable lifelong learning and a modern system of social security together with impetrative productive social dialogue. This increased flexibility in employment relations, necessary for employers to achieve and maintain market competiveness, at the same time, represents decreasing job security for workers. Within the concept of flexicurity it would be replaced by increasing employability of workers by developing their professional skills in the framework of the lifelong learning system which enable them greater labour market competiveness. Furthermore, with measures of active labour market policy, this, apart from promoting employment, supports workers in the transition between two jobs. Workers who have lost their jobs as a result of numerical flexibility achieve income security through unemployment benefits within a system of social security. In order to understand flexibility and security in employment relations in the Republic of Croatia, the authors have observed the mutual interplay of flexicurity elements in the labour market and the extent to which reforms in legislation, politics and institutional framework have influenced their implementation. After an analysis of the solutions de lege lata by which flexibility-security nexus is attempted to be established, the authors provide suggestions de lege ferenda for a more successful implementation of flexicurity policy on the Croatian labour market.

Keywords: *Croatian labour market, flexicurity, labour law reform*

1. INTRODUCTION

Right up to 1990, companies in the Republic of Croatia were mainly protected from the influence of world markets through a centrally organized production and distribution and domination of manufacturers on the domestic market. The work market was strictly regulated, so that workers enjoyed a high level of employment protection and work stability. With the opening up of national economy to global competition, domestic companies were

forced to adopt their inputs (including work), technology production and outputs to market demands. This mentioned transition period was marked by a high rate of unemployment which, according to the interpretation of numerous policy creators and a large proportion of the population, was the consequence of strict worker-protection legislation and a relatively generous system of social protection. With a packet of structural adaptations, including the introduction of flexible forms of employment and the reduction of social protection, transforming the labour market under these new market conditions was attempted as the only way. Croatian labour legislation was amended with newly established employment services and work market policy easing the introduction of these stated changes by reducing the high level of employment protection. Protection of employment was attempted to be achieved through legal provisions regulating the activity of employment services, income support and active labour market programmes. However, weaknesses regarding labour market institutions and collective bargaining combined with weak legal implementation contributed to a high rate of flexibility in the labour market, due to which workers began to perceive their jobs as unstable and insecure.

The labour market in the Republic of Croatia is currently going through a period of fundamental changes. Recent changes in labour legislation, reducing fiscal burdens, modernizing institutions and efforts to improve social dialogue and competences creating effective policy measures have provoked significant changes in the system.

Here the authors observe to which extent the Republic of Croatia in its labour and social security legislation and labour market policy has included elements of the operational concept of flexicurity (flexible employment contracts and work organizations, active labour market policy, a system of reliable long life learning and a modern system of social security with indispensible productive social dialogue) which the European Commission particularly promotes (European Commission, 2006, p. 15-20; 2007)

2. CROATIAN LABOUR MARKET – STATE AND BASIC CHARACTERISTICS

The Croatian labour market is characterized by segmentation, relative underdevelopment and low worker mobility, and at the same time by indications of increased spatial and inter-sector worker and job movement. Regarding segmentation of the Croatian labour market obvious are, on the one hand, a relatively inflexible formal sector, regulated by national legislation in which work relations are relatively stable, particularly in the public sector, and on the other hand a flexible informal sector, of which a certain part is legal, but unregistered, and a part is unregistered and illegal. These two mentioned segments are mutually intertwined and conditioned which means that increased rigidity and a lack of available jobs in the formal sector leads to the creation of greater activity in the informal sector. Also, the same is characterized, by the phenomenon of horizontal and vertical segregation reflected in the main spheres of gender inequality, in particular regarding employment, work quality according to level of education, career development, level of salary and so on. (Bilić, 2014, p. 127)

Regarding social security dialogue, in particular union activity, it can be said that they are mainly active in the public sector and large companies (of which most are privatised). On the other hand, the small and middle enterprise sector does not ensure a stable environment and union activity in this area is small or non-existent which leads to insecurity in employment relations. An important characteristic of collective barging in Croatia is its high level of decentralization (occurring mainly at company level). Here it should be noted that fragmentation of the union movement contributes to the underdevelopment of collective barging at activity level as does the widely held opinion of unions that negotiations with management will more quickly achieve their interests than negotiations with employer associations. On the other hand, employers hold structure rigidity responsible for making worker employment difficult. These are firstly: high salary taxes, risk of changes in labour

legislation, high costs of other production factors apart from work, inaccessibility of workers with needed skills, and high employee dismissal costs (Kunovac, Pufnik, 2015, p. 8). Given that, in the previous period, most Croatian companies were exposed to some form of economic shock (lack of liquidity, demand shock, unfavourable means of financing), they adapted themselves to the newly emerged conditions by reducing labour costs wherein the dominant strategy was individual employee dismissal, not renewing temporary contracts, and freezing, that is, reducing new employment. Furthermore, even though in times of economic crisis, almost a third of companies used the measure of reducing wages, we still cannot talk about financial flexibility in the Croatian labour market, where salary level is linked to worker effectiveness.

Employment in the formal sector today in more than 92% of contracts takes place by forming fixed-term contracts (*HZZ* (Croatian Bureau of Employment), Monthly Bulletin of Statistics, p. 5). The duration of fixed-term contracts is also an indicator of stability in employment relations. The tendency is to form fixed-term contracts for ever increasingly shorter periods of time and radically decreasing the amount of so called open contracts (open ended contracts) the duration of which depends on the demands of a certain job for which the contract is formed. The afore-mentioned points to an increase in the number of concluded employment contracts, but also to the worsening position of workers seeking employment. The mid nineties of the last century onwards have been marked by a traditionally weaker rate of employment of females who wait for employment longer than men. This is still the consequence of the dominant cultural stance according to which males are the providers for the family while women take care of the children and elderly in the family and the household. This situation is made even more complex by inadequate and exorbitantly priced institutions for taking care of children and the elderly (Bilić, Laleta, Barešić, 2016, p.63-96).

The number of those who work in more than one job bears witness to the standard of Croatian workers. Comparing average monthly income and the relatively high cost of living we come to the conclusion that a certain amount of the employable population is employed in several jobs in order to cover existential needs. In the structure of the employed it is obvious that ½ of such workers have regular additional jobs, 1/3 work casually and about 1/5 seasonally. According to Croatian Employment Bureau statistics, an increased fluctuation of registered unemployed persons has been noted who register a few times per year in periods between jobs of short duration with a fixed-term employment contract (*HZZ*, monthly bulletin of statistics, p. 8-52). Duration of work with the same employer is also one of the indicators of stability in the labour market. Namely, even though when forming employment relations the duration of the contract expresses the employer's intention on establishing permanent employment relations, it does not guarantee protection against later deviation which is witnessed by the large number of dismissed workers in the time of transition even though they all had permanent employment contracts. In order to understand flexibility and security in employment relations in the Republic of Croatia it is necessary to take into account the mutual activity of the mentioned segments in the labour market and their activity under the influence of changes in the legislation, policy and institutional framework.

3. IMPLEMENTATION OF FLEXICURITY POLICY IN THE CROATIAN LABOUR MARKET

Here we demonstrate solutions *de lege lata* within the area of labour and social security law which have influenced the establishment of elements of the operational concept of flexicurity.

3.1. Reform to labour and social security legislation

Reforms to the Labour Act in the Republic of Croatia implemented in 2003 - 2004, 2009, and 2014 influenced the flexibilization of strict employment protection legislation enabling the

use of flexible forms of employment and flexible organisation of work. However, for the implementation of flexicurity it was necessary to compensate for the increased job insecurity caused by this mentioned flexibilization in the labour market through active policy in the labour market promoting employment particularly for socially sensitive groups in the population. In this sense, it was necessary to support the system of social security offering income security in periods of unemployment and a system of lifelong learning for the workforce, promoting the adaptation of worker skills and competences to the labour market, thereby enabling him/her to remain in that labour market. In this context, in the mentioned period, and additionally from 2014 to 2017. the bringing in of the following laws and their novellas has affected the implementation of the flexicurity policy: Act on Mediation for Job Placement and Rights during Unemployment, Employment Incentive Act, Act on State Aid for Protecting Workers Employment, Act on Vocational Rehabilitation and Employment of Disabled Persons, Act on Occupational Safety, Act on Compulsory Health Insurance, Pension Insurance Act, Croatian Qualifications Framework Act, Act on Representativeness of Employer Association and Trade Unions. The mentioned legislative reforms, implemented with the aim of harmonising Croatian labour and social security legislation with EU regulations, simultaneously attempts to implement the policy of flexicurity in the Croatian labour market.

What has been achieved by the mentioned legislative reforms in the context of elements of operational concept of flexicurity?

3.2.Flexible and reliable contractual arrangements

In the Republic of Croatia there is a high level of numerical flexibility which enables employers to hire workers based on atypical, non-standard contracts (so called outsiders). Firstly, here fixed-term contracts are used (Bilić, 2004; Bilić, Perkušić, 2016), work through a temporary employment agencies (Laleta, 2015) and employment at an alternative workplace (distance work (Bilić, 2011)). In particular, the use of the institute of fixed-term contracts is flexibilized, which is evident from the large number of such concluded contracts. Namely, to conclude the first fixed-term contract, an objective reason is not necessary and it can be concluded for a period of more than three years (Art. 12.). Employees who work at an alternative workplace have been given a particular form of protection through an Act on Occupational Safety which defines this institute emphasising that it may not be concluded for short-time work. Furthermore, when carrying out inspectorial supervision at an alternative workplace, the inspector in charge is authorised to oversee protection of the life and health of others who are directly present near that workplace (Art. 3. para. 1. subparagraph. 4., art. 36. sec. 5 and art. 90 sec. 3.).

A more flexible form of employment certainly contributes to the institute of work through temporary work agencies. With the novella from the Labour Act (Art. 44. – 52.), the time in which the user undertaking can use the work of the assigned worker has been raised from one to three years. The possibility of regulating (by a collective agreement formed between the agency, that is, agency association and union) less favourable work conditions for agency workers in relation to workers employed with user undertakings in the same jobs has been introduced. Similarly, the right to remuneration in circumstances when the temporary worker is employed permanently by the Agency and is not assigned to user undertaking has been prescribed.

However, numerical flexibility can be seen in facilitated dismissals. During the mentioned reform period, the length of notice period was shortened and severance pay amounts were reduced. Moreover, in order to avoid misuse of temporary incapacity to work during the duration of notice period, the Labour Act specially prescribes that if a break occurred during the notice period due to worker incapacity to work, worker's employment relationship shall

be terminated at the latest on expiry of six months after the date of notice of termination of the employment contract. (Art. 121. p. 4.).
When the employer within the notice period releases the worker from work obligations, the notice continues during holidays, paid leave and the period of temporary incapacity to work (Art. 121. p. 5.). The above mentioned has influenced further shortening of notice periods.
In the case of business conditioned dismissal and dismissals on personal grounds, the employer is no longer obliged to employ workers in other appropriate work positions or to retrain workers or to additionally train them.
In collective redundancies (Art. 127. p. 1.) employer obligation is abolished regarding formulating a social plan. However, the employer is obliged to observe and explain all the possibilities and suggestions which could remove planned cessation of workers' jobs after the Workers' Council comments on the submitted data and employer intention (Art. 127. p. 4.).
Here it should be mentioned that the conditions are stricter for establishing a Workers' Council. Namely, up until the last novella of the Labour Act, the procedure for establishing a Workers' Council could be initiated by no less than 10 percent of the workers employed by certain employers, but, now or at the Union's suggestion, by 20 percent of workers employed by certain employers. Similarly, obligatory arbitration has been introduced in the case that Workers' Council consent is waived in the dismissal of protected categories of workers.
For the first time in Croatian labour law, the possibility of posting employees to a company associated with him has been prescribed (Art. 10. p. 3.-7., and art. 18. p. 4). This institute provides employment security to those workers whose work employers temporarily do not need, while the employer is freed from dismissal costs (Gović Penić, 2015, p. 13-44).
Since reforms to the Labour Act, the level of temporal flexibility has been increased which enables employers to, by better organization of hours of work, adapt their business to market demands. The greatest flexibilisation has been achieved precisely in the latest version of the Act through the institute of patterns of working time and redistribution of working time (Art. 66. and 67.). Namely, in redistribution of working time, the employer can independently decide on the worker's work up to 56 hours a week. On the basis of that same institute, the worker can work more than 56 hours up to a maximum of 72 hours weekly (limited by daily and weekly rest), but only if such a possibility is decided on by collective agreement. The referred to period of 4 months is in question. The longest daily hours of work has not yet been established, but has only been limited by daily periods of rest (12 that is 8 hours for seasonal workers).
Provisions on breaks have also been amended. Namely, The part-time worker or minor at two or more employers with total daily working hours at all employers of at least 6 and 4.5 hours respectively, shall be entitled to a break at each employer proportionate to his contracted part-time work. (Art. 73. p. 3.). Also a novelty is the establishment of rights to proportional annual leave for the worker who does not satisfy the condition for the acquisition of entitlement to annual leave for that calendar year (Art. 78.). The right to annual leave shall be determined for the worker as a number of working days depending on the his/her weekly working time pattern. National holidays and non-working days stipulated by law, periods of temporary incapacity for work assessed by competent physician and days of paid leave shall not be counted in the period of annual leave. However, where the worker should work on the day of holiday or a non-working day stipulated by law, but instead upon his request uses annual leave, that day shall be counted in the period of annual leave. (Art. 79. p. 1-3).
Regarding functional flexibility enabling workers the acquisition of multiple skills on the basis of which they can be allocated quickly to other tasks within the employer's work organization (Cridland, 1997, p.21; Farnham, Horton, 1997, p.18-33), The Labour Act provides duty for an employer In line with his capacities and business requirements, to ensure schooling, education, vocational as well as professional training for the worker, in particular

in the event of changes to or introduction of new patterns or organisation of work. Also, the worker has a duty to educate and train him/herself for work. (Art. 54-59). Financial flexibility by the very Labour Act itself has been established extensively, given that, collective contracts, rulebooks on work and employment contracts represent the sources which provide basis and criteria for salaries. Limitations only exist through the institute of minimal wages established by the Act on minimum wages.

3.3. Active labour market policies

Active labour market policies are considered to be necessary for achieving a balance between flexibility and employment security, reducing the risk of segmentation of the labour market and overall unemployment (European Commission, 2006; OECD, 2006**).** Legal foundations for introducing measures of active labour market policies are firstly contained in the Act on State Assistance, Act on Mediation for Job Placement and Rights During Unemployment, Employment Incentives Act, Act on State Aid for Protecting Workers Employment and the Act on Vocational Rehabilitation and Employment of Disabled Persons. Directions for the development and implementation of active labour market policies in the Republic of Croatia have also been adopted for the period between 2015 to 2017, and represent a national strategic document for a three year period which sets priorities and goals in the area of overall employment policy and these are: increasing the rate of employment, improving competiveness, increasing worker mobility through professional, spatial and education mobility and ensuring harmonisation between supply and demand in the labour market. Certain groups at whom active labour market policies are aimed are young unemployed persons, older persons and special needs persons. Measures consist of: employment support (abolishing support for employing persons without work experience which has been replaced by measures of professional training for work without conclusion of employment contract for a period of up 36 months, however professional training is now available to persons who have completed high school lasting four years but with a limit/ up to the age of 30 (Art. 7-10 Amendments to the Employment Incentives Act), self/employment and professional development and retaining jobs, public works, educating the unemployed, as well as measures which do not belong to active employment policies in a narrow sense, but influence the labour market such as formulating a professional plan for job seeking, individual counselling and meetings as well as professional rehabilitation.

The procedure for private and company legal entities have been made easier domestically and internationally for carrying out activities related to employment intermediation. Namely, before the enactment of the new Act on Mediation for Job Placement and Rights during Unemployment, for carrying out the mentioned activities these persons needed a permit from the authorised Labour ministry while pursuant to the renewed provisions before carrying out activities are only obliged to register in the authorised ministry for employment's records (Art. 4. sec. 7.).

3.4. Modern social security systems

Modern social security systems offering adequate unemployment benefits, as well as active labour market policies, are essential components providing income security and support during job changes. Pursuant to the Act on Mediation for Job Placement and Rights during Unemployment, the right to unemployed benefit is acquired by unemployed persons who at the time of cessation of work relations, or cessation of carrying out of independent work, has spent at least nine working months in the last 24 months, and according to precisely determined presumptions (Art. 38-41). The basis for establishing the amount of unemployed benefit for someone who has stopped working is made up of the average gross salary earned within the three month period preceding cessation of work or service. For someone who has

carried out work independently, it is made up of the base average on which compulsory insurance contributions were calculated and made established by special regulations in the three month period preceding cessation of the carrying out of independent work. If it cannot be established in this way, the base is established according to the minimum wage reduced by compulsory insurance contributions paid, depending on the percentage of time spent at work (Art. 42.).

The procedure for gaining rights established by this law is initiated at the demand of the unemployed person. At the first level, it is decided upon by regional organizational Departmental units and at the second level by the central organizational Departmental unit (Art. 63.). Regarding rights to monetary benefits for unemployed persons, the deadlines are regulated by the new law for unemployed persons whose job ceased on the basis of the relevant court's decision in a way that the decision is considered within the time limit if it was submitted within 6o days from the date of the court decision-s of its validity on the basis of which the job ceased (Art. 38. sec. 3.). The possibility of registering again in the unemployment records is regulated more flexibly where the department has ceased to register these persons. These are persons who are not actively seeking work and are not available for work) in that it has shortened the period for refusing registration to be able to re-register in the records from six to three months (Art. 19.).

From the aspect of flexicurity, it should be mentioned that the status of the insuree in health insurance pursuant to the Act on Compulsory Health Insurance, among others, is acquired by: persons who are undergoing professional training for work without forming employment relations, that is, those who are undergoing professional training for work with the possibility of using measures of active employment policy pursuant to certain social regulations, those using their right to professional rehabilitation, persons with residence (or permanent residency permit) in the Republic of Croatia who do not have compulsory health insurance in any way and have registered within 30 days of the day of job cessation, that is carrying out activities or from the day of cessation of compensation, those who on the 30th day of the day they turned 18 years of age if they do not possess any kind of health insurance, persons who have ceased working because a legal entity has sent them to be educated or undergo professional development while still working and persons with registered residence or permitted permanent residency in the Republic of Croatia and are employed in another member country or third country, that is, who do have not compulsory health insurance pursuant to state regulations as determined by EU regulations, or international contracts (Art. 7. sec. 1. t. 1, 3, 5, 6, 7, 11, and 13). Pursuant to the normative which regulates transnational health protection, the insured person has the right to the paid means of compulsory health insurance in other member countries (Art. 26. sec. 1.). This law in our health insurance system has introduced compulsory health insurance for students attending school and students over 18 years of age at the latest to the end of the academic year in which they finish their education for a duration of no more than 8 years if they do not acquire rights to health insurance in any other way (Art. 7. sec. 14.). Simultaneously, these mentioned rights are also acquired by full-time pupils and students over the age of 18 years of age attending schooling in other member states (Art. 7. sec. 15.).

A law has particularly been regulated for part-time work (at the longest up to 60 days) when your chosen doctor states that the state of health of the insuree, whose temporary work incapacity has lasted continuously for at least six months, has improved and that working part-time would be useful to more quickly reinstate the insuree's health to be capable for full-time work (Art. 46. sec. 3.). The mentioned arrangement maintains professional skills and enables functional flexibility.

However, the law differently regulates the insuree for salary compensation during temporary work incapacity. The insuree acquires that right at the expense of the Department or state

budget for a maximum duration of 18 months for the same continuous sickness diagnosis (Art. 52. sec. 1.). After the deadline of 18 months, the insuree acquires the right to monetary salary compensation benefit of up to 50% of the last received remuneration in the name of that temporary incapacity right up until medical indications exist for that temporary incapacity (Art. 52. sec. 2.).

The Pensions Insurance Act in our system or retirement insurance has introduced important changes of which the most significant are: the basis of conditions for acquiring old age and early old age pension, introducing measures which stimulate insurees to remain longer in the world of work and acquire old age pensions, introducing rights to early old age pensions related to employer bankruptcy, introducing new possibilities for evaluating worker capacity, changes to presumptions for acquiring rights to family pensions, rights on the basis of life partnership, invalid pension due to partial loss of work capacity together with determining jobs that the insuree can do, and temporary invalid pensions have been introduced for insurees who after completing professional rehabilitation remain unemployed, while a new harmonisation of pensions model has been introduced. So, this law, in particular from the flexicurity aspect encourages a longer stay in the labour market, enables using the old age pension together with part time work, and thereby enables the worker to remain longer at work. A consequence is the difficulty which our pension system funds itself due to the economic crisis and the problem of unemployment. Namely, in the first pension column for August 2013, 1. 22 mm pension users were registered compared to 1.50 mm insurees (therefore, a ratio of 1:1.23). This situation was impossible to maintain for further implementation of the existing pension system.

As more and more persons in the labour market were employed part time, in particular it is necessary to emphasise that pursuant to this law (Art. 27. sec. 3.) in the working life of the insuree, the period insured spent in part time work is also counted. The duration which, matches the hours of work gained for certain years calculated for full-time work. Particularly for fulfilling pension years of work conditions for acquiring rights to pension insurance, the period spent working part-time is considered as a period spent working full-time (Art. 27. sec. 8.). Assumptions for calculating years of work insured is also applied when hours of work are achieved with two or more employers (Art 27. sec. 4.), while the period spent working in seasonal jobs where more hours of work are achieved than with full-time work is regulated separately (Art. 27. sec. 5.), as are users of the invalid pension due to partial loss of working capacity (Art. 27. sec. 6.). Concerning the right to the early old age pension due to employer bankruptcy, insures who have after cessation of insurance due to bankruptcy directly before fulfilling conditions for the right to the old age pension and in continuation for at least two years as an unemployed person and have registered with the authorised unemployment bureau are also eligible. (Art. 36.).

3.5. Comprehensive lifelong learning strategies

This system ensures worker adaptability and employment, and maintains the level of company productivity. In recent years in the Republic of Croatia, certain efforts have been made to improve this situation and include lifelong learning. Namely, the Strategy for Lifelong Professional Direction and Career Development in the Republic of Croatia for 2016 – 2020 has been introduced. So too have certain regulations starting with the Croatian Qualifications Framework Act which attempts to increase transparency and the quality of the overall system of education, link education with labour market needs and to establish a system of recognising and acknowledging different types of learning.

3.6. Social dialogue- *conditio sine qua non*

One of the prerequisites for the development of flexicurity and its effective implementation is supportive and productive social dialogue between social partners and public authorities, their

mutual trust and highly developed system of industrial relations. In the introductory observation we dealt briefly with problems related to social dialogue in the Republic of Croatia which still exist regardless of the bringing in the Act on representativeness of employer associations and trade unions who set the criteria for the election of representative organizations, whereby promoting better representation in the world of work and the world of capital.

4. CRITICISM *DE LEGE LATA* AND SUGGESTIONS *DE LEGE FERENDA*

In the breakdown of the norms by which the Republic of Croatia in its labour and social security legislation and labour market policy included elements of the operational concept of flexicurity naturally should start from the institutes of labour law regulated by the Labour Act and we can summarise these under the operational element of flexicurity – flexible employment contracts and work organizations. In fixed-term contracts, the Labour Act enables a flexibile approach to the presumptions of concluding fixed-term contracts under Croatian law. Such an approach under conditions of a high level of unemployment certainly contributes to a greater possibility of opening up new jobs. However, under circumstances of frequent new changes to norms which relate to this institute, court practice has not succeeded in creating set legal understandings which could provide answers to these open ended questions which leaves open the possibility for varied interpretation, and therefore, legal insecurity and finally misuse of this institute. Due to this, solutions *de lege ferenda* must be made more precise to establish presumptions for forming that type of work relation, and limit the time available to form a temporary work contract. The institute of part time work still is rarely used in the Republic of Croatia regardless of the legal possibilities. The reason for this is on the part of the employers who lack the culture of work and knowledge linked to the organization of work and short term business planning. Namely, they, in times where there is an increase in work, prefer to use overtime which often, thanks to the inefficiency of work inspection services, do not pay for, but in the best scenario compensate for with days off. From the workers' perspective mainly for women, who most often work part time, the problem of not enough and expensive services of care for children and the elderly play a large part in preventing women from entering the labour market. Temporary agency employment has been made easier, time for assigning workers who apart from their bare wages do not enjoy any other collective agreement material benefits to which workers employed directly by user undertaking have the right which places temporary agency workers in a precarious position in relation to work conditions. The institute of work at an alternative workplace is inadequately regulated. Namely, the only article which deals with the obligatory content of contracts for jobs in alternative workplace protect neither the business interests of employers nor provide the worker with adequate protection in particular in the context of harmonising private and work life.. Through the possibility of assigning workers among related employers, security of employment is provided to those workers for whose work employers temporarily do not need, and the cost of dismissal of workers is reduced which represents a useful contribution in Croatian labour law legislation from the aspect of flexicurity. However, as it concerns a new institute, it should be *de lege ferenda* completed in a way that the norms provide answers to open dilemmas regarding the issue of to whom the worker during this agreement is responsible in the sense of fulfilling his/her work obligations and who is considered to be the employer of the temporarily assigned worker while the agreement lasts. We believe that temporal flexibility in the Labour Act has been too extensively determined, which enables employers to organize working time in a way that in some areas the daily rest only lasts for eight hours. Furthermore, in so far as organization of work does not allow employers to enable workers a weekly rest of 24 hours uninterrupted to which the daily rest period is added, this must be replaced by a period of rest after such circumstances

have ended. How long can such circumstances last for, that is, how long can a worker be made to work without with just 24 hours of weekly rest? The institute of redistribution of working time represents the biggest problem for two reasons. The first is related to removing the role of unions when determining hours of work of up to a period of 56 hour long work period given that such hours of work can only be given independently by the employer. The other problem is related to the fact that such a schedule of hours of work, especially when (if determined by collective agreement) can amount up to 72 hours a week and seriously deteriorates the psychophysical health of the worker as well as the possibility of harmonising his/her private and working life. Overtime is another problem which employers, thanks to the extensively determined conditions for its use, (which by the way to a large extent coincides with the conditions for forming a fixed-term contract) abuse instead of forming a fixed-term contract and/or part time one. The ideal solution which would unite protection of employers' business interests and saving the psychophysical wellbeing of workers would be to allow working overtime only in the case of extraordinary circumstances. However, that would only be possible in so far as the market had substitute workers possessing not only formal, but also the actual needed skills and capabilities for carrying out the job.

Novellas brought in the Act on Compulsory Health Insurance contribute to the social security of workers. This in particular is related to the norms regulating the right to transnational health protection (Art. 31. sec. 1.). However, there is no right to transport costs compensation (Art. 31. sec. 4.). Given the low level of average wages in the Republic of Croatia compared to the level of travel costs of developed European countries it is dubious whether the insuree can really independently cover the costs of that transport, sp uses the prescribed right of transnational protection due to which this norm *de lege ferenda* should certainly be amended in this sense. A significant novella from the flexicurity perspective is regulation the law from compulsory health insurance for full-time pupils and students over 18 years of age for a total duration of 8 years. Namely, in this way lifelong learning is encouraged because persons over the age of 26 and who study on this basis have the right to health insurance which they did not have before. Concerning the disadvantages, it should be mentioned that regulation does not enable comforting cooperation between The Croatian Department of Health Insurance with the Croatian Employment Bureau and the Croatian Department of Retirement Insurance.

When talking about the Pension Insurance Act, novellas which regulate the period of insuree working life spent in part–time work, and the novellas which extend insuree rights representative of a vulnerable group of workers, they certainly represent progress from the flexicurity aspect. However the same cannot be said for novellas increasing the limits for rights to old age pension and early old age pension. Nevertheless, lifting the age limit for pensions has been caused by the difficulties in which the pension system finds itself due to the economic crisis and problem of unemployment.

It is important to emphasise that the Republic of Croatia has made much progress regarding the introduction of measures of active employment policy. However, it must be stated that they cannot solve the problem of unemployment, which is within the domain of economic growth and development. Active labour market policy (*ALMP)* can help in (reducing) structural (frictional) disharmony between supply and demand, firstly by professional and spatial discrepancy between supply and demand and increasing labour market transparency. Similarly, in this way, *ALMP* can influence employment re-assignation in a way that less people are unemployed for a long time and /or are users of forms of social welfare. Croatia needs to develop clear and varied ways of further education, learning and employment preparation as parts of *ALMP*. Also, it is necessary to improve public programmes of training and professional development for the unemployed and other groups in an unfavourable

position. The type and importance of such programmes can be improved by encouraging participation at a regional and local level, and including all participants in the organization, offering and financing of services. At the same time, *ALMP* measures cannot be merely considered from a relatively short-term viewpoint, but rather it is necessary to also include their significance in improving the social security inclusion of participants, and long- term improvement in employability as a result of adopting new knowledge and skills thereby raising the competiveness of the entire national economy. In other words, that measures are a form of social security investment which aids participants in improving productivity and probably also with the possibility of creating more profit in the future. Furthermore, one needs to lean towards ensuring long-term financial sustainability of these measures, by simplifying the procedures for obtaining documents and reports and avoiding constantly changing conditions and characteristics of measures. Measures need to be adapted to changing conditions, but they also should lean towards stability and durability so that they do not lead possible users and workers of Croatian Bureau of Unemployment into situations of doubt, Finally, it is important to improve dissemination of information on the measures as well as reporting on their effectiveness in order to improve the image the wider public holds about the significance and activity of The Croatian Unemployment Bureau.

Furthermore, given the creation of labour market measures, the role of social partners in Croatia is to achieve a compromise of labour market flexibility labour and employment security. Most unions are against negative forms of flexibilisation, in so far that it includes greater accessibility and adaptability of workers to changes and employers' demands and they support a kind that offers them greater freedom on organization of work and private life by creating better possibilities of professional advancement, which encourages development of skills and employees' ambitions. This harmonisation of social partners' demands would be most easily implemented via decentralised collective bargaining, where both sides play a greater role and have more freedom to achieve their aims. Apart from the development of partner relations, social partners need to share responsibility for the development of worker expertise and skills and help them to maintain a high level of employability.

With the aim of a flexible workforce, Croatian employers need to emphasise the development of human potential, and the use of new technologies in managing human resources to create a workforce that is able to carry out various complex tasks and resolve various problems, and which, with its perimeters and structure can adopt to market demands. On the other hand, Croatian unions can help their members to free themselves from the belief that the worker for must stay in one place all his/her life and carry out the same type of work, but rather must be flexible, have security of employment which includes changing jobs and which is achieved through a system of lifelong learning, employment preparation and employment intermediation and measures of active labour policy through subsidised employment, retraining and additional training and activation.

Regarding lifelong learning, it should be emphasised that Croatia has a long and rich tradition of primary, secondary and tertiary education which offers a strong foundation for development. However, this is only a base. In the challenges which the global market brings, Croatia places the imperative on modernising the education system (curriculum and syllabi, pedagogies and the responsibility of those who offer these services). For example, the Bologna Process, which represents tertiary education reform in Europe, has not yet completely become a reality in university practice, and certain faculties are not able to implement it because of excessive student numbers and lack of space, teaching staff, professional associates, out of date programmes without the possibility of courses choice, poor cooperation with the economy, almost non-existent international mobility and a still poorly structured scholarship system. Croatia also needs to analyse its enrolment quotas at certain faculties and pursuant to economic and market needs direct and increase capacities at

science and technical faculties together with reducing numbers at faculties which generate unemployed degree holders or a large number of students, who after many years of study abandon studies. Instead of commencing work and filling the national budget, they begin to empty it by seeking social welfare benefits and costs of retraining and this is certainly not in Croatia's interest. We need to take on the model of lifelong learning because long term, it is the best investment, and certainly better than savings, bonds and lately risky shares. It will guarantee employment security and with it profit security until our skills, knowledge and capabilities are needed by employers in the competiveness battle. The longer we resist accepting and implementing lifelong learning, the bigger our costs and problems with adapting will be. Employers still view investing in additional education as an added cost and their decision depends on the amounts of government incentives and tax deductions for programmes of additional employee education. However, due to the ever increasingly accentuated market game, it is expected that government incentives in following years will not be what motivates companies to invest in their employees. The basic motive will be market survival and when companies begin to think this way increasing investment into education will occur regardless of the amount of government incentives. We can only hope for the quickest possible acceptance of such policy in Croatian companies.

5. CONCLUSION

Why then does the system not function, that is, why is the labour market still riddled with unemployment?

Improvement of flexibility and security depends on the way in which institutions are designed and whether sufficient investments in social and human capital are made to warrant high levels of commitment and productivity. Nevertheless, it should be stressed that the implementation of flexicurity is costly and, at the same time, the rigid fiscal and monetary policy framework set by the European Monetary Union is not favourable in the implementation of flexicurity as a whole. Croatia in this area has at its disposal very limited funds from the State Budget despite certain measures of financing from the European Social Fund. Furthermore, it is important to emphasise that social partners are the most important participants in the implementation of flexicurity policy. This proves that that policy has demonstrated itself to be the most effective precisely in those countries where social partners played a significant role in finding the balance between flexicurity and security in the labour market **(**Monks**,** 2007). It is understandable that social partners only support those changes in which they have personally participated which in practice shows to what extent they influenced the mentioned legislative reform. The results of implemented regulated measures in practice will show whether their aim was merely harmonisation with the regulations of the European Union, and the attempt to copy countries in which flexicurity policy is successfully implemented and that they have not taken into consideration all the specifics of the Croatian economy and labour market or their application will produce desirable positive effects in the labour market.

For successful implementation of flexicurity policy, it is necessary to, in particular, undertake the following steps: strengthen social dialogue and movement of the labour market with collective contracts, in particular for workers who work in non-standard employment relations in order to avoid a precarious level of their employment and avoid misuse of these institutes. Lastly, work inspection services should play an important role, the workers of which need to be additionally educated and undergo professional development. Education needs to point to the importance of lifelong learning and accessible measures of active employment policy. It is also important to work on changing culturological viewpoints regarding the abuse compensation for unemployment which exclusively must be considered as a transitional measures. It is necessary to change the stances that prevent better

harmonisation of business and private life in a way that increase the entry of women in the labour market, together with the indispensible increase of the number (as well as the lowering of costs for the services) of institutions of child care and care for the elderly. The education of employers plays an important role with regard to better organization of work by using flexible forms of employment, flexible hours of work, variable wages, investment in professional training and professional development of the work force. Finally government administration bodies must reinforce their own capabilities for horizontal coordination of activities, maximal and equal stimulation of citizens and educational institutions so that they can act in the direction of harmonising labour market demands and educational outcomes and planned ensuring of resources.

ACKNOWLEDGEMENT: *This paper has been fully supported by the Croatian Science Foundation under the Project UIP-2014-09-9377 Flexicurity and New Forms of Employment (the Challenges Regarding the Modernization of Croatian Labour Law.*

LITERATURE:

1. Bilić, A. (2004). Ugovor o radu na određeno vrijeme - usklađivanje radnog zakonodavstva Republike Hrvatske sa propisima Europske unije, Zbornik radova Pravnog fakulteta u Splitu, 1; 167-18.
2. Bilić, A. (2011). Rad na daljinu prema međunarodnom, europskom i hrvatskom radnom zakonodavstvu, Zbornik radova Pravnog fakulteta u Splitu, str. 631.-647.
3. Bilić, A. (2014). Ravnopravnost spolova u kontekstu fleksibilnih oblika rada, u: Perspektive antidiskriminacijskog prava, Potočnjak, Ž., Grgurec, I., Grgić, A., (eds.), Pravni fakultet Sveučilišta u Zagrebu, Zagreb.
4. Bilić, A., Perkušić, T. (2016). Ugovor o radu na određeno vrijeme kao modus implementacije fleksibilnosti na tržištu rada, Mostariensia – časopis za društvene i humanističke znanosti Sveučilišta u Mostaru, str. 199-218.
5. Cridland, J. (1997). Flexible friend and foe, People management, 3(24) :21; F.
6. European commission. (2006). Flexicurity: combining flexibility and security, Social agenda, no.13.
7. European commission. (2007). Towards common principles of flexicurity: More and better jobs through flexibility and security, accesses at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0359:FIN:EN:PDF (accessed: 29. March 2017.).
8. Farnham, D., Horton, S. (1997). Human resource flexibilities in the United Kingdom's public services, Review of Personnel Administration,.17(3):18-33.
9. Gović Penić, I. (2015). Novine u sklapanju ugovora o radu čiji je cilj fleksibilizacija radnih odnosa (privremeno ustupanje i dopunski rad radnika), Aktualnosti u radnim odnosima, Novi informator, Zagreb.
10. Hrvatski zavod za zapošljavanje. (2017). Mjesečni statistički bilten, accesses at: http://www.hzz.hr/UserDocsImages/stat_bilten_03_2017.pdf (accessed: 04. May 2017.).
11. Kunovac, M., Pufnik, A. (2015). Adjustment of labor costs in Croatia during the crisis – results from WDN survey, Hrvatska narodna banka, Zagreb.
12. Laleta, S. (2015). Rad putem agencija za privremeno zapošljavanje u hrvatskom, europskom i usporednom pravu, Zbornik Pravnog fakulteta Sveučilišta u Rijeci (1991) v. 36, br. 1, 305-340.
13. Laleta, S., Bilić, A., Barešić, A. (2015). New discourses in part-time work in the context of flexicurity, in: New developments in EU Labour Law and Human Rights Law, Vinković, M. (ed.), Osijek, p. 63-96.

14. Monks, J. (2007). Stakeholder conference on flexicurity, Brussels. accesses at: http://ec.europa.eu/employment_social/employment_strategy/pdf/flex_monks_en.pdf (accessed: 04. May 2017.).
15. Obrazloženje predlagatelja (Vlada Republike Hrvatske) uz prijedlog Zakona o mirovinskom osiguranju. (2013). accesses at: www.sabor.hr.
16. OECD. (2006). Employment outlook. accesses at: http://www.oecd.org/document/38/0,3343,en_2649_33927_36261286_1_1_1_37457,00.html (accessed: 04. May 2017.).
17. Smjernice Vlade Republike Hrvatske za razvoj i provedbu aktivne politike zapošljavanja u Republici Hrvatskoj za razdoblje od 2015. do 2017.g. (2014). accesses at: http://www.mrms.hr/wp-content/uploads/2015/02/smjernica-apz.pdf (accessed: 04. May 2017.).
18. Strategija za cjeloživotno profesionalno usmjeravanje i razvoj karijere u Republici Hrvatskoj 2016 – 2020. (2015). Vlada Republike Hrvatske. accesses at: file:///D:/Users/Trpimir/Downloads/Strategija%20CPU%20i%20razvoja%20karijere%20u%20RH%202016.-2020..pdf (accessed: 04. May 2017.).
19. Zakon o državnim potporama (N.n. br. 47/14).
20. Zakon o Hrvatskom kvalifikacijskom okviru (N.n. br. 92/13 i 41/16).
21. Zakon o minimalnoj plaći (N.n. br. 39/13).
22. Zakon o mirovinskom osiguranju (N.n. br. 115/13, 151/14, 33/15, 93/15 i 120/16).
23. Zakon o obveznom zdravstvenom osiguranju (N.n. br. 80/113 i 137/13).
24. Zakon o posredovanju pri zapošljavanju i pravima za vrijeme nezaposlenosti (N.n. br. 16/17).
25. Zakon o poticanju zapošljavanja (N.n. br. 57/12, 120/12 i 16/17).
26. Zakon o potporama za očuvanje radnih mjesta (N.n. br. 93/14).
27. Zakon o profesionalnoj rehabilitaciji i zapošljavanju osoba s invaliditetom (N.n. br. 157/13).
28. Zakon o radu (N.n. br. 38/95, 54/95, 65/95, 102/98, 17/01, 82/01, 114/03, 123/03, 142/03, 30/04, 68/05, 149/09, 61/11, 82/12 i 73/13, 93/14).
29. Zakon o reprezentativnosti udruga poslodavaca i sindikata (N.n. br. 93/14 i 26/15).
30. Zakon o zaštiti na radu (N.n. br. 71/14, 118/14 i 154/14).

Economic and Social Development

IS THERE A STATISTICAL LINK BETWEEN THE REVENUES AND SELECTED EXPENDITURE OF REGIONAL SELF-GOVERNMENT OF THE REPUBLIC OF CROATIA

Ante Samodol
Libertas International University Zagreb, Croatia
asamodol@libertas.hr

Davor Zmegac
Libertas International University Zagreb, Croatia
dzmegac@libertas.hr

ABSTRACT

The role of regions in national economies has changed significantly in recent times, due to at least two reasons: (a) globalization and (b) needs for structural adjustment in the view of ever changing economic environment. When we talk about sub-national levels of organization of EU countries, usually we distinguish three groups (degrees). Units of the first level of organization of local government are closest to the citizens (cities, municipalities, communes and similar forms of organization). The second level, often referred to as intermediate, consists of units that present the transition from local to regional or federal level (county, district, province, territory, etc.). The third degree, the most powerful for its rights, is made up of regional units (regions) or federal states, if states are established as federations. In Croatia, regional units are called counties and there are twenty of them, plus the City of Zagreb which has the authority and legal status of both a county and a city. This paper examines statistical links between revenues of twenty Croatian counties in the period from 2002 to 2015 and the selected key expenditure functions in the mentioned period. The method used in the research is regression analysis. The models analyze the direction and strength of statistical links between the income of a county as dependent variable and four types of expenditure as independent variables. According to research results all four independent variables proved to be significant only in case of one county, while in case of all other counties all independent variables or a number of them proved to be insignificant.
Keywords: *Expenditure, Income, Regional self-government, Regression analysis*

1. INTRODUCTION

Fiscal capacity as an ability of local government units to finance the assigned functions, i.e. their own expenditure with their own budget, is an important indicator of the success of decentralization of the system. When we consider counties as units of regional level of government in the Republic of Croatia and in the light of the ongoing discussions about the territorial organization of the Republic of Croatia, it is interesting to explore the existing links between counties' income and their expenditure in order to come up with possible new findings that could be useful in the decision-making process which would be based on objectively researched and established indicators.

The first part of the paper gives a summarized overview of the existing organization of the subnational level in the Republic of Croatia and, in particular, the functional and fiscal framework of the counties. The main part of the paper presents a statistical model which was developed to determine the existence and strength of statistical links between the income of Croatian counties on the one side and the selected expenditure functions on the other. Based on the model, the final part of the paper presents the interpreted results.

2. REGIONAL SELF-GOVERNMENT OF THE REPUBLIC OF CROATIA

The territorial and organizational system of local and regional self-government in the Republic of Croatia is based on the Constitution from 1990, which guarantees its citizens the right to local and regional self-government and establishes counties as units of regional self-government. The Constitution also stipulates that the capital of Zagreb may legally have the status of a county, and the same legal status can be granted to other major cities in the country. The Law on Local and Regional Self-government (Official Gazette 33/01, 60/01, 129/05, 109/07, 125/08, 36/09, 150/11, 144/12, 19/13, 137/15) stipulates that a county is a unit of regional self-government whose area represents a natural, historical, traffic, economic, social and self-governing entity and is established in order to perform the affairs of regional interest.

The current territorial and organizational structure of the regional self-government units covers the period from the last local elections of 2013, including the latest changes made by the end of 2016. In the mentioned period, a total of 555 units of local self-government were established in the Republic of Croatia, of which: (i) 428 municipalities; (ii) 127 cities, and 20 units of regional self-government i.e. counties. The City of Zagreb, as the capital of the Republic of Croatia, has a distinct (dual) status of a city and a county, which means that there are 555 units of local self-government in the Republic of Croatia, 20 units of regional self-government and the City of Zagreb with its special status, which results in 576 local and regional self-government units.

Figure 1 shows the boundaries of municipalities, cities and counties within the existing territorial framework and the organization of local and regional self-government units in the Republic of Croatia.

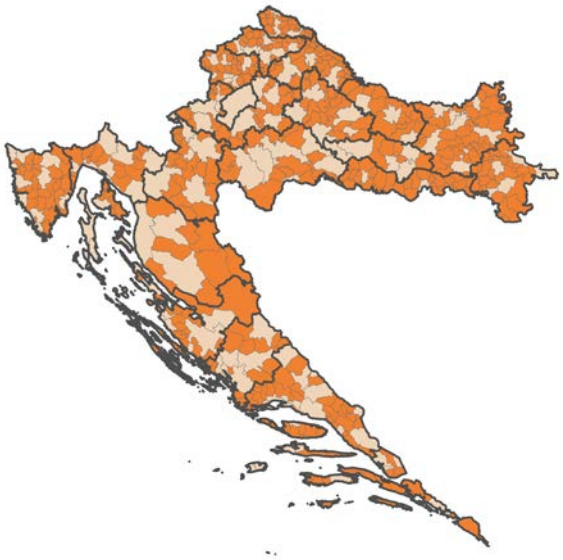


Figure 1: Boundaries of municipalities, cities and counties in the Republic of Croatia (Association of Cities of the Republic of Croatia, 2014)

As shown in Figure 1, municipalities (darker view) cover a significantly larger area of territory than cities (brighter view). The boundaries of counties follow the boundaries of municipalities and cities while the City of Zagreb has dual status. The counties of the Republic of Croatia are: Zagreb, Krapina-Zagorje, Međimurje, Varaždin, Koprivnica-Križevci, Virovitica-Podravina, Bjelovar-Bilogora, Brod-Posavina, Požega-Slavonija, Osijek-

Baranja, Vukovar-Srijem, Sisak-Moslavina, Karlovac, Lika-Senj, Primorje-Gora, Istria, Šibenik-Knin, Zadar, Split-Dalmatia and Dubrovnik-Neretva.
Within the scientific and expert public, and at the level of political parties and the general public, a dialogue has been opened on the justification of the existing territorial system, primarily from the aspect of the existing significant fragmentation of the system, as well as justification of the existing number of municipalities and cities and the need for the existence of twenty counties as regional units. Although a significant number of discussions are pointing in the direction of the need for defragmentation of the system, both at the local and regional level, for the time being this has not been introduced. Some minor or major changes in the functional and fiscal framework of the local government have occurred instead. Since the subject of this paper is related to the existing regional level, the continuation of this paper presents the functional and fiscal framework of Croatian counties, which is essential for the understanding of the created model. It should be noted that frequent administrative and territorial changes at the local and regional level have a significant impact on the quality of statistical data required for analytical research (Budak, Alibegović, Šišinački, 2004, p. 664).

2.1. Functional framework of regional self-government

Ever since the emergence of the modern state in Europe, the time when a special administrative subsystem has differentiated itself and acquired its own identity within the state system, administration affairs have been carried out by the state or state administration (Pusić, 2007, p. 330). Thus, there are jobs in the state that are not carried out by individual citizens, but are performed by the society or by the state based on the decision of the ruling party. These jobs serve to meet the general and collective (common) needs. Such jobs are called public jobs and are performed by various public administration organizations. Public jobs can be central and local. Central jobs are government jobs and jobs of other entities of the central government, and local jobs are self-managing jobs within the working sphere of the local and regional units and authorities. In this system there is a question of which jobs, from a wide range of public needs, should be central and which should be local. Decentralization deals with these questions and all the questions regarding redistribution of power, responsibilities and finances and whatever else is needed to ensure efficient public services within different levels of administration. Decentralization is a tool for vertical division of government and constraint of political power and an organizational model serving to increase the efficiency of public administration (Kregar, 2011, p. 1). The principle behind decentralization is the principle of subsidiarity, which requires that every jurisdiction is placed where it can be relevantly used and taking into consideration the political dimension, decisions about it should be made at the level closest to the citizens. Organizational interpretation of subsidiarity implies that a higher entity does not assume functions that could be satisfactorily performed by a lower entity. According to the economic perception of the principle of subsidiarity, the provision of any public service should be left to the lowest levels of government allowing for a full acceptance of the beneficial effects (and costs) associated with that service. (Ploštajner, 2002, p. 40).

According to the provisions of the Law on Local and Regional Self-government (Official Gazette 33/01, 60/01, 129/05, 109/07, 125/08, 36/09, 150/11, 144/12, 19/13, 137 / 15) counties have to deal with regional affairs (tasks) related to: education, health care, spatial and urban planning, economic development, traffic and transport infrastructure, public roads maintenance, planning out networks of educational, health care, social and cultural institutions, granting location permits and other construction-related certificates, as well as implementation of spatial planning documents for the areas further away from large cities, and other activities in accordance with specific laws.

Towns with more than 35,000 inhabitants (big cities) and county center towns can also perform jobs which are under the jurisdiction of counties. Also, local self-governments (cities and municipalities) may take over certain jobs from a county's domain, providing they follow the prescribed procedure and have sufficient funds. With all necessary decisions made, a county has the possibility to transfer part of its affairs to local self-government units, and the state may, under the law, delegate certain state affairs to a county, whereby the state is obliged to settle the incurred costs from the state budget.

2.2. Financing the counties of the Republic of Croatia

Given that the local government, in accordance with the principle of subsidiarity, assumes the obligation to perform a certain proportion of public affairs that are in the interest of the community, it follows that local and regional self-government units have to have the funds needed for the preparation and realization of those activities but also for other required activities in order to maintain and enhance the social and economic level of the territory, which is under the jurisdiction of certain local government units. Alexis de Toqueville noted more than a century ago, "The federal system was created with an intent to combine various advantages that result from the strengths and weaknesses of nations" (1980, v.1, p.163). But to understand these "various advantages" we need to understand which functions and instruments work better if they are centralized, and which work better at the level of decentralized government. This is the main issue of fiscal federalism. As part of the Public Finance theory, fiscal federalism is focused on the vertical structure of the public sector. It studies, from a normative and positive point of view, the role of different levels of government and the ways in which they relate to one another through instruments such as payment and distribution of funds between different levels of government (Oates, 1999, p. 1120). Thus, fiscal federalism studies the possibilities of optimal and efficient financing of public services and needs in relation to the specific level of government, i.e. which level of government can perform certain public functions and public affairs in the most rational way. The model of redistribution of resources between different levels of government results, along with a significant number of exogenous factors (knowledge, natural preconditions, benefits of the location, etc.), in the ability of the local government to efficiently realize the public affairs it had been put in charge of.

The ability of local government units to finance their budget expenditures with the allocated budget funds is called fiscal capacity. Fiscal capacity is one of the fundamental indicators of the extent of centralization or decentralization of the central and local government. Although the power of a particular city or municipality's fiscal capacity does not depend solely on the distribution policy of revenue-gathering powers, in certain cases a particular unit may have significantly higher fiscal capacity due to its location or mining rents or some other similar capital or natural impact of an activity within the territory of the unit, yet the degree of local government's ability to finance budget expenditures by its own budget is largely dependent on central government fiscal policy in relation to the local government. Local government units finance a significant part of their expenditures in collaboration with central government, which provides grants from the central government (national) budget via the Ministry of Finance or the competent ministries. Greater local government unit autonomy can be found in connection with the performance of the communal economy activity, preschool education and cultural, sporting and religious activities (Bajo, Bronić, 2005, p. 6).

According to the aforementioned theoretical assumptions, by assigning public affairs to the local state, the Constitution of the Republic of Croatia has determined that local and regional self-government units are entitled to their own revenues that they can freely use in order to

efficiently perform their assigned jobs. By saying this, the level of income must be proportional to the needs of their assigned jobs. The Law on Local and Regional Self-government (Official Gazette 33/01, 60/01, 129/05, 109/07, 125/08, 36/09, 150/11, 144/12, 19/13, 137/15) has determined that the sources of income of the units of local (regional) self-government are as follows: 1. municipal, city or county taxes, surtax, different types of fees and contributions; 2. income from their properties and property rights; 3. income from companies and other legal entities in their ownership, or in which they have shares; 4. concession fee received by their representative body; 5. fines and confiscated property gains for infringements prescribed in accordance with the law; 6. shares in joint taxes with the Republic of Croatia; 7. funds and grants of the Republic of Croatia estimated by the state budget; 8. other income determined by the law. The basic financial act of local and regional self-government units is the budget, and the main regulation dealing with financing in detail is the Law on Financing of the Units of Local (Regional) Self-Government (Official Gazette 117/93, 69/97, 33/00, 73 / 00, 127/00, 59/01, 107/01, 117/01, 150/02, 147/03, 132/06, 26/07, 73/08, 25/12, 147/14, 100/15, 115/16). Table 1 shows the financing system of the counties of the Republic of Croatia according to sources.

Table 1: Croatian counties' sources of finance (Authors' systematization)

-Ends on the next page-

Source of income	**Structure**
Tax revenues (own and shared)	**County taxes (own taxes in their entirety) -** inheritance and gift tax, road motor vehicle tax, boat tax, slot and gaming machine tax (Law on Local Taxes, Official Gazette 115/16) **Share in common taxes -** The latest amendments to the Act (Official Gazette 100/15) prescribe the distribution of the income tax revenues that is applied from January 1, 2016 in a way that 16.5% of the income from tax revenues earned within each territory of the counties belongs to them, the share for decentralized functions is 6% (primary and secondary education 1.9% and 1.3%, social welfare 0.8%, health care 1% and fire protection 1%), the share for the balancing position in the state budget is 16%, and the share used to assist projects co-financed by European funds is 1.5%. The share of the City of Zagreb in the income tax distribution represents both the city and the county share and amounts to 76.5% (60% + 16.5%) due to its status of the City of Zagreb and of a county. Municipalities, i.e. cities with the status of assisted area under special regulation (development index lower than 75% of the Republic of Croatia's average) get 88% of the income tax share, while the remaining 12% is allocated to the county. Municipalities and towns with the status of hilly and mountain areas, which at the same time belong to group III and IV according to local self-government units development, i.e. whose development index amounts to between 75% and 125% of the Republic of Croatia's average, get a share of 70.5% of the income tax earned on their territory, which is increased by the value of the assumed decentralized functions. County's share is 12%, which is also increased by up to 6%.
Non-tax revenues	Charges, fees and other non-tax revenues according to special regulations
Income from grants (donations)	**Conditional transfers** - transfers made within decentralized processes **General or non-conditional aid -** is intended for those areas of local and regional self-government that are located in areas of special state concern, hilly and mountain areas and on islands or assisted areas according to the Development Index (Assistance for local and regional units of self-government in 2017 planned by the state budget for the distribution 025 - MINISTRY OF FINANCE - Article 39, Paragraph (1) as compensation for income tax returns to citizens per annum

	application / Article 39, Paragraphs (2) and (3) for the profit tax of local self-government units that have the status of assisted areas / Article 39, Paragraph (4) in the amount of assistance planned for 2014 / Article 39, Paragraph (5) assistance according to the development index of local and regional units of self-government with the status of assisted areas / Article 40, Paragraph (1) of the local self-government unit with status of special state concern with development index > 75% (group III according to development index - 30%, group IV -15% and group V -5% of the amount in 2013 from profit tax and increased share in personal income tax) / Article 40, Paragraph (3) local self-government units in hilly and mountain areas with a development index > 75%) **Project grants -** forms of grants provided by central government bodies which can be provided in the form of liquid and capital transfers intended for entrepreneurial programs and capital investments.
Capital income	Income from financial and non-financial assets
Debit	The Government may grant approval of debit to local and regional self - government units, which should not be higher than three percent of the total operating income of all local and regional self-government units reported in the financial record of income and expenses, receipts and expenditures for the period from January 1 to December 31, 2016. The total annual commitment of the local or regional self-government unit which is indebted, by borrowing and granting the guarantees /consent, shall not exceed 20% of the budget revenues earned in the year proceeding the year in which it is debited, with an exception of: projects co-financed by the European Union for energy efficiency improvement.

As shown in Table 1, local and regional self-government units have the following sources of income: (i) tax revenues (both own and shared); (ii) non-tax revenues (iii) income from grants (aids), (iv) capital incomes, and (v) debit. According to estimated data, total revenues of counties in 2016 amounted to 4.1bn HRK of which: 1.5 bn HRK are tax revenues (37% in total revenues); 1.7 bn HRK are aid (41% in total revenues); 0.3 bn HRK are property income (5% in total revenues) and 0.7 bn HRK are other revenues (17% in total revenue).[1]

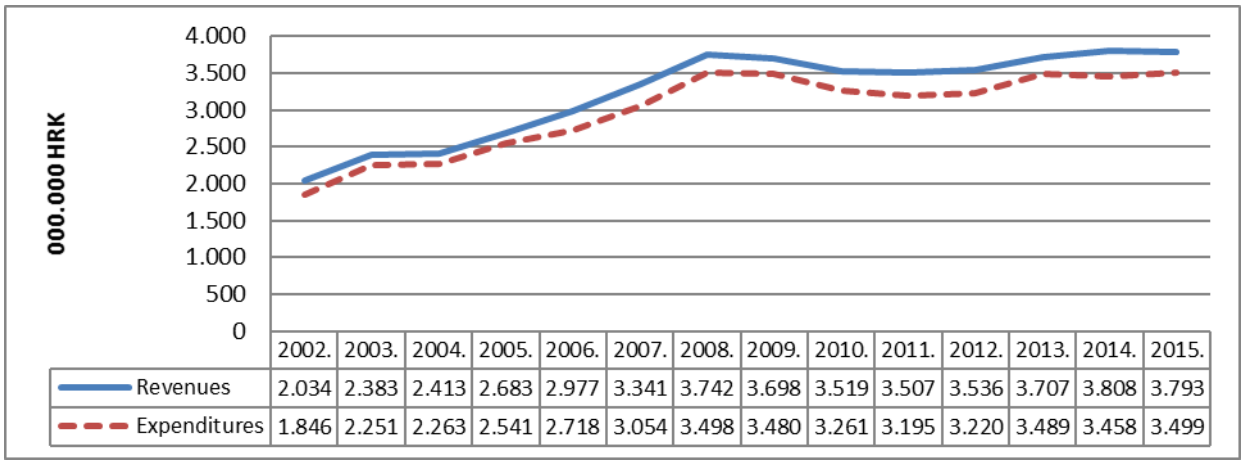
3. ANALYSIS OF THE DIRECTION AND STRENGTH OF STATISTICAL LINKS BETWEEN THE INCOME AND SELECTED EXPENDITURE OF REGIONAL SELF-GOVERNMENT OF THE REPUBLIC OF CROATIA

The specific aim of this paper is to determine the existence and the strength of the statistical link between the income of Croatian counties on the one side and the selected expenditure functions on the other, with regard to the determined territorial organization of the counties of the Republic of Croatia and their functional and financial (fiscal) framework. The research on the statistical link between the income of Croatian counties in relation to the selected expenditures was based on the following elements: (i) the period covered is from 2002 to 2015 and according to the data of the Ministry of Finance of the Republic of Croatia; (ii) twenty Croatian counties were investigated, while the City of Zagreb was excluded due to its significantly positive deviating indicators which could not ensure the consistency of the model; (iii) the *Multiple Linear Regression - Ordinary Least Squares* method of regression analysis was applied, and the models analyzed the direction and strength of the statistical link

[1] Data from the Ministry of Finance of the Republic of Croatia, Counseling of the Croatian Community of Counties in Poreč, March 22-24, 2017, in Poreč, Croatia.

between the county budget revenues as dependent variable and four types of budget expenditures as independent variables; (iv) four expenditure functions were selected according to the Ordinance on Budget Classifications (Official Gazette 26/10 and 120/13).

In the observed period from 2002 to 2015, twenty counties had cumulative revenues of 45.1bn HRK and expenditures amounting to 41.8bn HRK as shown in Chart 2.



	2002.	2003.	2004.	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	2014.	2015.
Revenues	2.034	2.383	2.413	2.683	2.977	3.341	3.742	3.698	3.519	3.507	3.536	3.707	3.808	3.793
Expenditures	1.846	2.251	2.263	2.541	2.718	3.054	3.498	3.480	3.261	3.195	3.220	3.489	3.458	3.499

Chart 2: Revenues and Expenditures in the Republic of Croatia for the period of 2002 - 2015 (Authors' systematization)

Chart 3 shows the annual growth rates of revenues and expenditures for all observed counties in the Republic of Croatia in this period. The increase of revenues in all counties amounted to 66.4%, and the increase in expenditure was by 2.8% higher, amounting to a total of 69.2%.

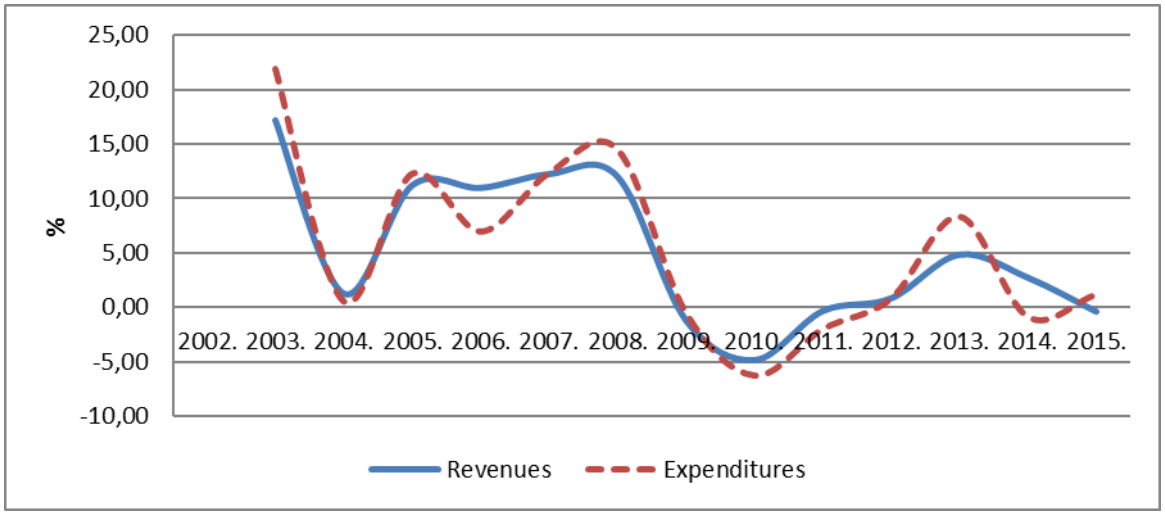


Chart 3: Annual Rates of Revenues and Expenditures for all counties in the Republic of Croatia for the period of 2002 - 2015 (Authors' systematization)

Chart 4 shows counties' budget revenues and expenditures in relation to the GDP *per capita*. It becomes clear that after the crisis years in which the business of the counties was aligned with the GDP *per capita* indicator, during the last couple of years, separation occurred again primarily in relation to the expenditure of counties' budgets.

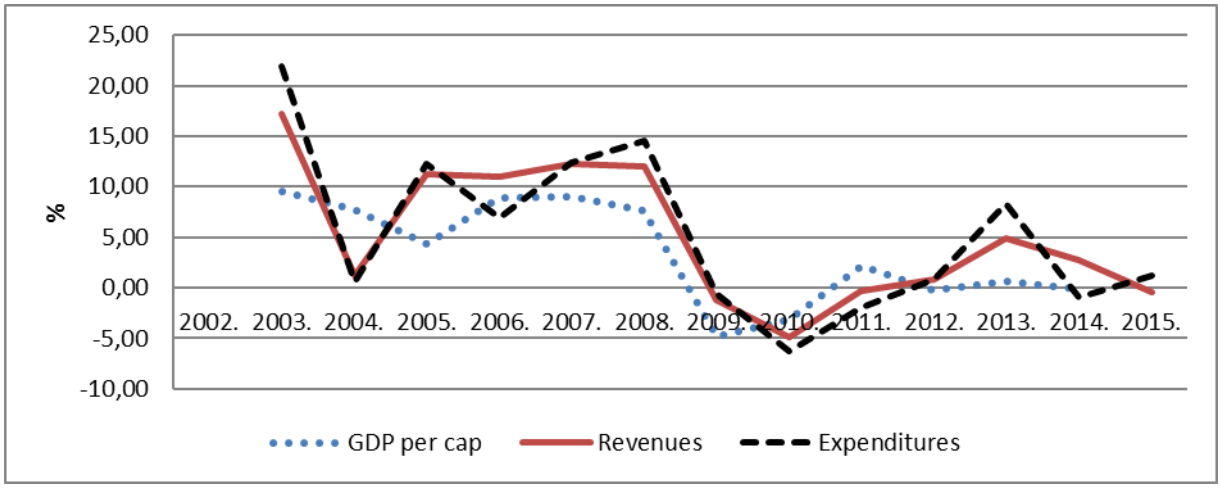


Chart 4: Correlation of GDP per capita with revenues and expenditures of twenty counties of the Republic of Croatia for the period of 2002 – 2015 (Authors' systematization)

Article 14 of the Ordinance on Budget Classifications (Official Gazette 26/2010) stipulates that the numerical codes and the names of the functional classification are to be taken from the United Nations International Classification of Economic Activities (COFOG) - Classification of expenditures according to their purpose. The Classification of the Functions of Government (COFOG) was developed by the Organization for Economic Co-operation and Development (OEC) and published by the United Nations Statistical Division (IMF, 2014, p. 79, Annex to Chapter 6). COFOG has three levels of detail: divisions, groups, and classes. The ten divisions could be seen as the broad objectives of government, while the groups and classes detail the means by which these broad objectives are achieved. According to COFOG the functions of government are divided into ten divisions (1st level): 1) general public services, 2) defense, 3) public order and safety, 4) economic affairs, 5) environmental protection, 6) housing and community amenities, 7) health, 8) recreation, culture and religion, 9) education and 10) social protection. The divisions of the classification are divided into 69 groups (2nd level) and groups are broken down into classes (3rd level) (Vassiljeva, 2012, p. 64.). For the purposes of this paper four functional expenses according to COFOG divisions were selected: 1) general public services; 4) economic affairs; 7) health and 9) education.

3.2. The model

By using multiple regression analysis model:

$$Yi = \alpha + \beta 1Xi1 + \beta 2Xi2 + \ldots + \beta jXij + \ldots + \beta KXiK + \varepsilon i, \qquad i = 1,2,\ldots,n.$$

and applying the OLS method, based on the empirical data of revenues and expenditures for each individual county, the direction and strength of the statistical link between selected expenditures as independent variables and revenues as dependent variables was established (Levin, Rubin, 1998, p. 682) (Annex 1).

In the model Yi stands for each county's revenue, while Xi1 represents expenditures for general public services, Xi2 expenditures for economic affairs, Xi3 expenditures for health care, and Xi4 expenditures for education. This is the way to establish the extent to which counties' revenues are determined by the planned and actual county expenditures with the view of achieving the goals arising from the area of authority.

Resulting from the simple average calculation, these four independent variables make up 78% of all counties' expenditures, which additionally demonstrates the importance of establishing the link between the counties' functional expenditures and revenues.

The analysis has shown that out of twenty analyzed counties, all four types of expenditure have proven to be significant variables in the model in only one county. Also, three types of expenditures appear as significant variables that are statistically related to county revenues in only two counties. Four counties don't even have any kind of expenditure as a significant variable in determining county revenues, and in 6 counties only one type of expenditure is significant, which is half of the total number of counties (Table 2). Finally, in 7 counties only two variables are significant, so it can be said that in seventeen counties or in 85% of the cases there are two or less variables that proved to be significant and that on average account for 78% of their expenditures.

Table 2: Number of counties according to the number of non-significant variables (Authors' systematization)

Variable No.	0 variables	1 variables	2 variables	3 variables	4 variables
County No.	4	6	7	2	1

Furthermore, by analyzing the size and direction of the obtained parameters of some significant variables, it became clear that education was a significant variable in 11 counties, with the highest positive parameter being 2.84 and the lowest 0.91 for every one million kuna of education expenditures. The ratio between the highest and the lowest parameter is 3.1. On the other hand, health expenditures are significant in only 5 counties, with the highest positive parameter being 7.91 and the lowest only 1.54 per one million kuna of health expenditures. The ratio between the highest and lowest parameter is 5.12, which is quite high. General public services are both expenditures and significant variables in 9 counties, with the highest positive parameter of 2.64 and the lowest of 1.00 for each one million kuna of expenditures. Expenditures for economic affairs are significant in only 5 counties where the highest positive parameter is 3.55 and the lowest 0.96. The number of counties according to significant variables' type is shown in Table 3.

Table 3: The number of counties according to significant variables' type (Authors' systematization)

Expenditure type	General public services	Economic affairs	Health care	Education
County no.	9	5	5	11

Based on the analysis of annual growth rates of GDP *per capita* and the annual growth rate of county budget revenues and expenditures, a positive correlation was established: (a) a strong correlation between annual growth rate GDP *per capita* and budget revenues (p-value 0.0013) and (b) a medium correlation between the growth rate GDP *per capita* and the before mentioned budget expenditures (p-value 0.0082), as shown in Table 4.

Table 4: Correlation of annual rates of GDP per capita and county revenues and expenditures for the period 2002-2015. (Authors' systematization)

Correlations for all pairs of data series with p-values			
pair	Pearson r	Spearman rho	Kendall tau
percap;reven	0.8133	0.8322	0.697
p-value	(0.0013)	(0.0014)	(0.001)
percap;expend	0.7202	0.7063	0.5455
p-value	(0.0082)	(0.0133)	(0.0138)
reven;expend	0.9589	0.9231	0.7879
p-value	(0)	(0)	(1e-04)

A weaker correlation between the annual GDP rate *per capita* and the annual rate of the selected expenditures indicates that there is room for optimization of the functional expenditures of county budgets. The largest individual *per capita* of a county is 97.000,00 HRK (Istria County), while the lowest is in Virovitica-Podravina County and amounts to 43.000,00 HRK. The difference of 54,000.00 HRK corresponds closely to the total GDP average of all counties *per capita*, which amounts to 56,000.00 HRK. The range between the highest and the lowest amounts that present deviations from the average (+41,000.00 HRK or 73%) and (-13,000.00 HRK or 23%) indicates that the existing model of financing of revenues and dealing with functional expenditures is not correlated with the achieved GDP level of individual counties, even though the needs of citizens for good-quality public services are equal.

4. CONCLUSION

By using the multiple regression analysis model and applying the OLS method, based on the empirical data of revenues and expenditures for each individual county for the period from 2002 to 2015, the direction and strength of the statistical link between the four selected expenditures as independent variables and revenues as dependent variable was established.

Based on the developed model, it can be said that according to the criterion of functional types of county expenditures as significant variables, health and economic jobs appear only in five counties, while general public services appear in nine counties, and education as a significant variable occurs in eleven counties. Therefore, one of the mentioned variables proved to be insignificant for determining a county's functional expenditures and revenues in 50% (general public service, education) to 75% (economic jobs, health) of the overall number of counties. This could be interpreted as a result of a non-homogeneous structure of public services and infrastructures distributed by counties, and as an indicator of uneven demographic trends in counties where there are not enough people (consumers) for certain type of services, so we can say that the network of observed public services is not optimized.

The relation between the indicator of county budget revenues and expenditures and the GDP *per capita* proved to be significant because it has been established that after the crisis period in which a county business was aligned with the GDP *per capita* indicator, in recent years separation has occurred, which is primarily negative in relation to the expenditures of county budgets, indicating that the budget funds at the counties levels in the Republic of Croatia are insufficiently balanced. This imbalance requires a higher quality, more precise functional framework for the counties, followed by fiscal support for the implementation of a standard

minimum for public services, which should be precisely defined and fairly distributed regionally. Additionally, it is justified to think about a different regional organization that would balance the regional GDP *per capita* as a significant element in reducing regional inequalities. More so, it is necessary to further strengthen the rules regarding functional classification since there are visible differences in the ways of recording expenditures by functional parts which affects the accuracy of analytical research.

Annex 1. List of counties only with significant variables and parameters (processed data)

Counties	Variable	Parameter	S.E.	T-STAT H0: parameter = 0	2-tail p-value	1-tail p-value
ME	econ[t]	1.903487	0.706573	2.693972	0.024636	0.012318
DU	gen[t]	2.640879	0.714079	3.698301	0.004934	0.002467
	econ[t]	3.548011	1.321.634	2.684564	0.025018	0.012509
ISTRA	gen[t]	1.345785	0.448361	3.001568	0.014918	0.007459
	health[t]	5.731565	1.024.328	5.59544	0.000336	0.000168
	edu[t]	1.905834	0.457339	4.167223	0.002422	0.001211
ST	edu[t]	2.841991	0.843394	3.36971	0.008261	0.00413
VU	health[t]	1.541622	0.318732	4.836733	0.000925	0.000463
	edu[t]	1.015316	0.250034	4.060708	0.002839	0.001419
ŠI	gen[t]	2.027092	0.609626	3.325141	0.008867	0.004434
	edu[t]	1.404622	0.460861	3.047822	0.013842	0.006921
OS	econ[t]	2.45948	0.787257	3.124112	0.012237	0.006119
	edu[t]	1.403633	0.417431	3.362548	0.008355	0.004178
BROD	gen[t]	1.00327	0.171957	5.83441	0.000249	0.000124
	econ[t]	1.332251	0.176937	7.529513	3.6E-5	1.8E-5
	health[t]	1.637573	0.165245	9.909962	4.0E-6	2.0E-6
	edu[t]	1.208044	0.076063	15.882147	0	0
PŽ	gen[t]	2.049755	0.7593	2.699533	0.024412	0.012206
VT	gen[t]	1.525566	0.406362	3.754205	0.004525	0.002263
	econ[t]	0.961984	0.091321	10.534101	2.0E-6	1.0E-6
	edu[t]	1.031315	0.19672	5.24255	0.000533	0.000266
LIKA	gen[t]	1.428055	0.5727	2.493546	0.034222	0.017111
	health[t]	7.910335	2.323.879	3.403937	0.007824	0.003912
PRIMOR	gen[t]	2.065873	0.812362	2.543044	0.031553	0.015776
BJ	gen[t]	1.210862	0.534298	2.266266	0.049665	0.024833
	edu[t]	0.946747	0.139656	6.779122	8.1E-5	4.0E-5
KC	edu[t]	0.905899	0.214631	4.220734	0.002237	0.001119
VŽ	edu[t]	0.957068	0.146531	6.531515	0.000107	5.4E-5
ZGB	health[t]	4.022007	135.025	2.978712	0.015482	0.007741
	edu[t]	1.242711	0.303044	4,10076	0.002674	0.001337

LITERATURE:

1. Bajo, A., Bronić, M. (2005) Fiscal Decentralisation in Croatia – Problems of Fiscal Equalisation. *Occasional Paper No. 25,* Zagreb: Institute of Public Finance.
2. Budak, J., Alibegović, J. D., Šišinački, J. (2004.) Local government and development in Croatia: Are we lost in transition? *Ekonomski pregled 55* (p. 660-673), Zagreb: Hrvatsko društvo ekonomista.
3. Croatian Bureau of Statistic (2016). *Statistical Yearbook of the Republic of Croatia*. Retrived 04.05.2017. from http://www.dzs.hr/
4. Kregar, J, Đulabić, V, Gardašević, Đ, Musa, A, Ravlić, S, Lugarić, T.R., (2011). *Decentralizacija.* Zagreb: Centar za demokraciju i pravo Miko Tripalo.
5. McLave, J. T., Benson G. P. (1994). *Statistic for Business and Economics.* New York: Macmillan College Publishing Company.
6. Ministry of finance (2017). Retrived 08.05.2017. from http://www.mfin.hr/hr/statistika-i-izvjesca.
7. Levin, R. I., Rubin, D. S. (1998). *Statistic for Management.* New Yersey: Prentice Hall Inc.
8. Narodne novine. *Zakon o financiranju jedinica lokalne i područne (regionalne) samouprave (NN 117/93, 69/97, 33/00, 73/00, 127/00, 59/01, 107/01, 117/01, 150/02, 147/03, 132/06, 26/07, 73/08, 25/12, 147/14, 100/15, 115/16).* Retrived 08.05.2017 from https://www.zakon.hr/z/411/Zakon-o-financiranju-jedinica-lokalne-i-područne-(regionalne)-samouprave.
9. Narodne novine. *Zakon o lokalnoj i područnoj (regionalnoj) samoupravi, pročišćeni tekst zakona (NN 33/01, 60/01, 129/05, 109/07, 125/08, 36/09, 150/11, 144/12, 19/13, 137/15).* Retrived 08.05.2017 from https://www.zakon.hr/z/132/Zakon-o-lokalnoj-i-područnoj-(regionalnoj)-samoupravi.
10. Oates, W. E. (1999). An Essay on Fiscal Federalism. *Journal of Economic Literature* (p. 1120-1149). Pittsburgh, American Economic Association.
11. Ploštajner, Z. (2002). Decentralizacija uprave. *Decentralizacija i sudjelovanje građana na lokalnoj razini: Iskustva i problemi zemalja Jugoistočne Europe* (p. 40-54) Zagreb, Zaklada Friedrich Ebert, Ured u Zagrebu.
12. Pusić, E. (2007). *Država i državna uprava.* Zagreb: Društveno veleučilište u Zagrebu.

SOME ASPECTS OF EARLY-STAGE ENTREPRENEURS' FINANCIAL RESOURCES DIVERSITY

Blaz Freser
University of Maribor, Faculty of Economics and Business
Razlagova 14, 2000 Maribor, Slovenia
blaz.freser1@um.si

Polona Tominc
University of Maribor, Faculty of Economics and Business
Razlagova 14, 2000 Maribor, Slovenia
polona.tominc@um.si

Miroslav Rebernik
University of Maribor, Faculty of Economics and Business
Razlagova 14, 2000 Maribor, Slovenia
miroslav.rebernik@um.si

ABSTRACT

Ensuring resources is one of the most important activities of early-stage and of established businesses. Among various resources, financial resources play the key role. In our paper, the Global Entrepreneurship Monitor (GEM) research framework was used to analyze different aspects of early-stage entrepreneurs' financial resources diversity concerning the financial investment amounts and the diversity of these resources. The GEM database for the year 2015 is used to analyze European countries which participated in the GEM 2015 survey with the emphasis on Slovenian early-stage entrepreneurs. Our research results bring several valuable findings. First, the majority of early-stage entrepreneurs finance their entrepreneurial activity to a great extent by their own financial resources. In Slovenia, on average as many as 96% of early-stage entrepreneurs do so, which is above the European average. Second, the average amount of financial investment differs as regards the development stage of an economy. That is, in the innovation-driven economies, this amount is approximately four times as high as compared with the efficiency-driven economies. Third, the perceived average amount of financial resources needed differs regarding the age of early-stage entrepreneurs, regarding their growth aspirations as well as regarding the innovative characteristics of their businesses. Those who are up to 35 years old perceive, on average, a lower amount of financial resources needed compared with those who are older than 35 years. The early-stage entrepreneurs with higher growth aspirations (in terms of new job creation) and those whose early-stage businesses have innovative character (in terms of the characteristics of their products/services and in terms of competition) perceive, on average, higher amount of financial resources needed as compared with those who are non-innovative and those with lower growth aspirations.

Keywords: *Early-stage entrepreneurs, European countries, Financial resources, Global Entrepreneurship Monitor, Slovenia*

1. INTRODUCTION

There is no doubt about the importance of financial resources for the enterprises and the entrepreneurial activity in national economies. Access to financial resources is therefore one of the key elements that has influence on the development and growth of small and medium-sized enterprises (IFC, 2011) of which many belongs to the early-stage entrepreneurs. The

lack of financial resources or inadequate financial resources may lead to inability of proper functioning of these enterprises or to the inability of proper realizations of entrepreneurial opportunities. This could negatively influence the growth process of these enterprises (Carter and Van Auken, 2005; Eddleston et al., 2014; Wu et al., 2007; Bewaji et al., 2015; Shane and Cable, 2002). This implies that the acquisition of financial and other resources is one of key challenges of modern entrepreneurial process (Grichnik et al., 2014). In our paper, GEM research framework was used to analyze different aspects of early-stage entrepreneurs' financial resources diversity, especially concerning the financial investment amounts. The GEM database for the year 2015 is used to analyze European countries which participated in the GEM 2015 survey with the emphasis on Slovenian early-stage entrepreneurs. On this basis the special chapter in Slovenian GEM report for the year 2016 (Rebernik et al., 2017) and global Special topic report (Daniels et al., 2016) were also prepared. The possibility of comparisons with findings referring to other countries and regions participating in GEM is a big advantage of this world-wide research project. Namely, GEM in 2015 included 60 participating countries. The multi-country studies of entrepreneurial activity are essential, since they enable the comparison and replication of specific research, which is important for several stakeholders, especially for the economic policy makers (Terjesen et al., 2016). This is especially important for a small country like Slovenia, since the results may be analyzed in comparison with other economies at the similar development stage.

In this paper, we therefore represents some key aspects of Slovenian early-stage entrepreneurs' financial resources diversity, such as own financial resources used, average amount of financial resources needed and differences in perception of these amounts between entrepreneurs regarding their age, growth aspirations as well as regarding the innovative characteristics of their businesses. With several comparison of Slovenian early-stage entrepreneurs with early-stage entrepreneurs from Europe and the cluster of innovation-driven economies, we have provided the international comparability of our research findings.

2. EARLY-STAGE ENTREPRENEURS' FINANCIAL RESOURCES DIVERSITY

GEM defines early-stage entrepreneurs as individuals at the beginning of entrepreneurial process, and follows them with the Total Early-stage Entrepreneurial Activity (TEA) index. TEA indicates the prevalence of adult individuals (18 to 64 years of age) engaged in nascent and/or new entrepreneurship. Nascent entrepreneurs are those who have taken steps to start a new business (to own and manage it at the same time), but have not yet paid salaries or wages for more than three months. New entrepreneurs are running new business as (co)owners and managers that have been in operation for between 3 and 42 months (Daniels et al., 2016, p. 21). Entrepreneurs finance their entrepreneurial activities with different financial resources, where formal types of this financial resources (according to GEM methodology) represent resources from banks, private investors or venture capital investors, government and resources form crowdfunding platforms, while the informal types of financial resources represent resources from family, friends, employers and own money (own resources). Own financial resources represent the most important and common way for early-stage entrepreneurs to finance their entrepreneurial activity in their ventures. The reasons for usage of informal financial resources could be the voluntary decision of each entrepreneur or the inability to obtain formal types of financial resources (Rebernik et al., 2017, p. 141).

Figure following on the next page

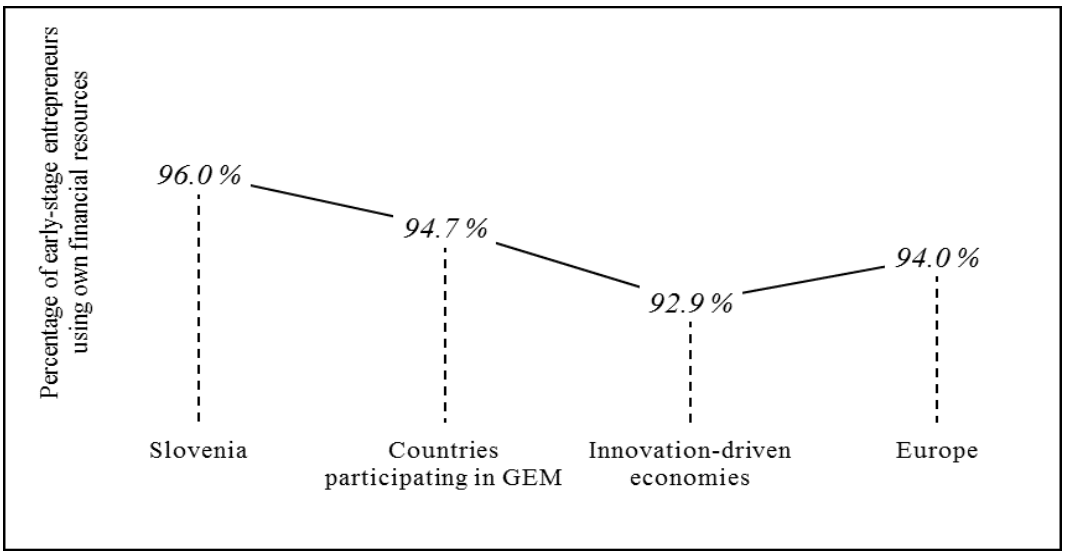


Figure 1: Percentage of early-stage entrepreneurs using own financial resources (Source: Rebernik et al., 2017)

Figure 1 represents the percentage of early-stage entrepreneurs who use own financial resources to finance their ventures. As figure shows approximately 95 % of all entrepreneurs (world-wide: countries that participate in GEM research for the year 2015) use or have used at least once in the past, some amount of own financial resources to finance their ventures. In Europe, this percentage is very similar (on average 94 %) and vary between countries from 79 % in Spain, to 98 % in Croatia, Romania and United Kingdom, and to the 100 % in Macedonia. In Slovenia, 96 % of early-stage entrepreneurs use or have used their own financial resources, which is above average of European and innovation-driven economies (countries). This could be due to conditions that are more rigid in Slovenian economy and to other factors which make it difficult for entrepreneurs to obtain external (and formal) financial resources (Rebernik et al., 2017, p. 142-143). In the innovation-driven economies the average percentage of early-stage entrepreneurs who use own financial resources is lower, approximately 93 %. The next important point of view in this research is the total amount of financial investment. The average amount of financial investment differs as regards the development stage of an economy. On average, entrepreneurs from innovation-driven countries of Europe and North America require the highest amount of capital to start a business, while entrepreneurs from Latin America, Africa and the Caribbean the lowest amount. In these regions factor- and efficiency- driven economies predominate, and the low start-up costs are probably a reflection of the type of ventures started by entrepreneurs in these regions (Daniels et al., 2016, p. 21). The difference in the total amount of financial investment between factor- and efficiency- driven economies is not so large: entrepreneurs from factor-driven economies needed approximately € 3,700 to start their businesses while entrepreneurs from efficiency-driven economies approximately € 5,000. On the other hand, the difference between factor- and efficiency- driven economies in one group and innovation-driven economies, is much more extensive because entrepreneurs from the innovation-driven economies on average need over € 20,000 to start their businesses (ibid, 2016, p. 22). In Figure 2 the average total amount of financial investment is presented. We would like to point out that the average amounts in Figure 2 and in all other figures represented in the paper are calculated based on median values. This way we have successfully avoid some outliers that could have significant influence on arithmetic mean (average) value.

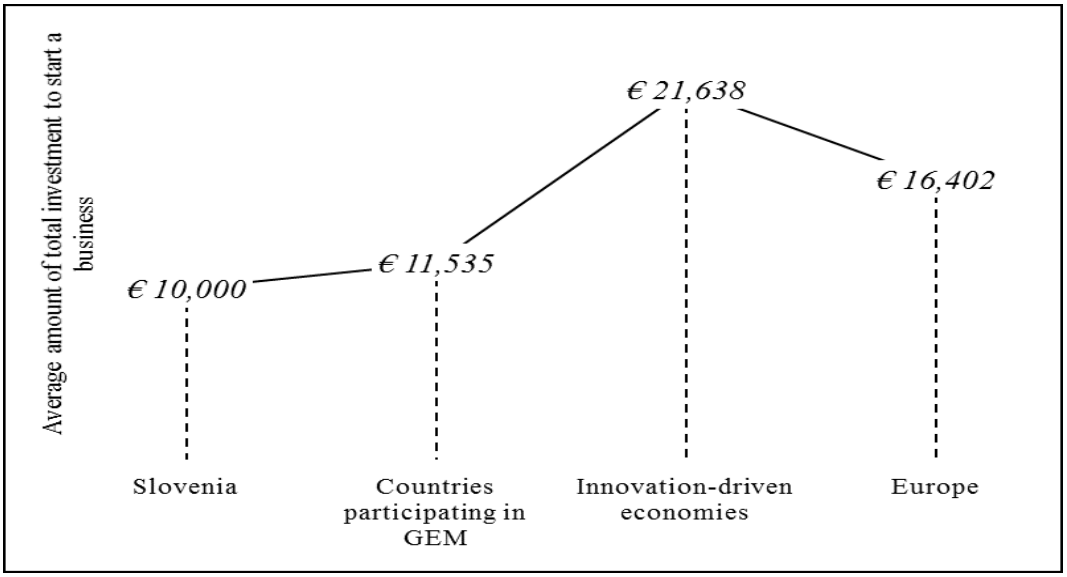


Figure 2: Average (of median) amount of total investment to start a business (in €) (Source: Rebernik et al., 2017)

As we can see from Figure 2 the Slovenian early-stage entrepreneurs on average need less financial resources that their counterparts (in context of average median amount) from other comparison groups. Thus early-stage entrepreneurs from all countries, which participate in GEM for the year 2015, needed on average approximately 11.5 % more financial resources as compared with the early-stage entrepreneurs from Slovenia. Early-stage entrepreneurs from Europe have approximately by 60 % higher financial needs as early-stage entrepreneurs from Slovenia. The biggest difference was recorded in comparison with early-stage entrepreneurs from innovation-driven economies, where entrepreneurs on average needed approximately twice as much as Slovenian early-stage entrepreneurs. Otherwise, the minimum median amount of total investment needed was recorded in Philippines (approximately € 200) and the maximum in South Korea with almost € 80,000 (Rebernik et al., 2017, p. 139).

Average median amounts of total investment required to start a business by age group of early-stage entrepreneurs, are presented in Figure 3. For this analysis, we didn't take into account the age group of 18-24 years, due to the lack of data for Slovenian early-stage entrepreneurs in this age category. As figure shows older early-stage entrepreneurs in Slovenia perceive on average higher financial needs as their younger counterparts. In the innovation-driven economies early-stage entrepreneurs aged 35-44 and 45-54 perceived on average the highest financial needs. When only countries from Europe participating in GEM 2015 are taken into account, the early-stage entrepreneurs that are older than 54 years perceive the highest financial needs.

Figure following on the next page

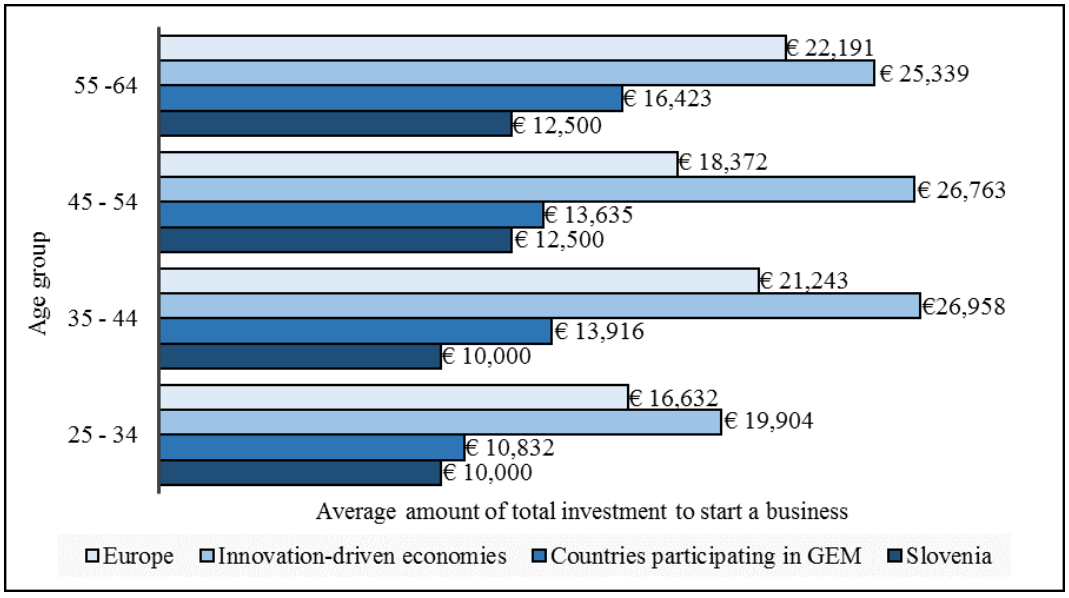


Figure 3: Average (of median) amount of total investment to start a business (in €), by age in Slovenia and selected groups (Source: Rebernik et al., 2017)

This finding is partly in line with general trend that was detected in all countries participating in GEM research. Although access to finance is a perennial problem for all small businesses, the younger entrepreneurs are particularly vulnerable to this limitation. Young entrepreneurs often have no credit history or assets to serve as collateral in order to secure loans from financial institutions. In the 25 to 34 age cohort, in addition, they may be a little less established in a career that may offer high salaries and perks (less opportunity costs) or they may have fewer financial obligations such as families to support and loan repayments (Daniels, 2016, p. 31). This also confirms past findings where it was found out that entrepreneur age can enhance capital acquisition and improved the ease of obtaining financial resources (Neeley and Van Auken, 2010, p. 25).

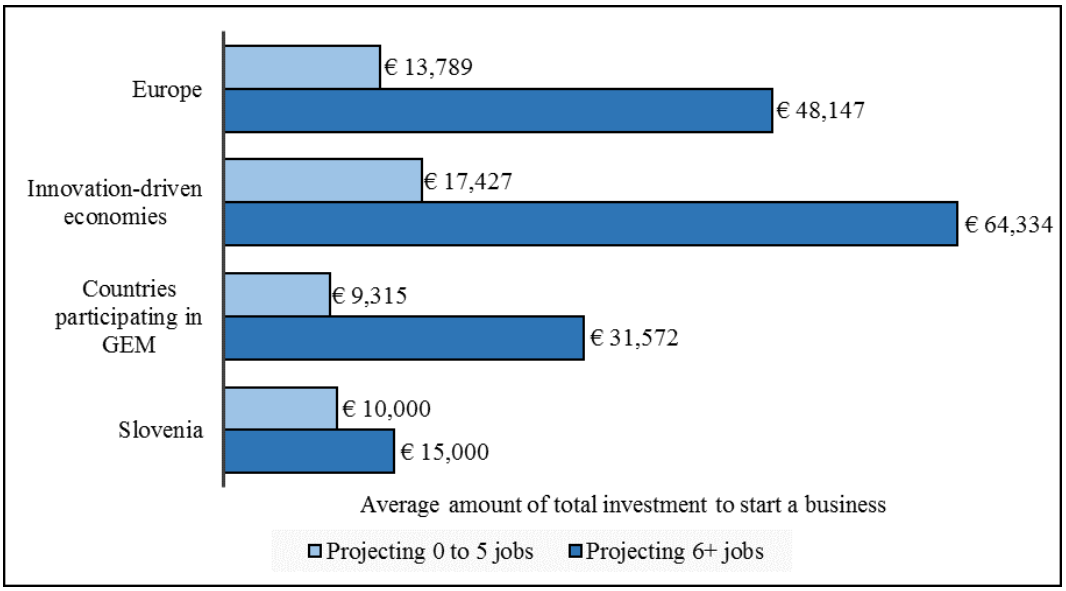


Figure 4: Average (of median) amount of total investment required to start a business (in €), by job creation aspirations in Slovenia and selected groups (Source: Rebernik et al., 2017)

The average median amounts of total investment required to start a business regarding growth aspirations of early-stage entrepreneurs for job creation, are presented in Figure 4. The figure enables comparison between early-stage entrepreneurs who anticipate medium or high employment growth (anticipate 6 or more jobs) and early-stage entrepreneurs with lower expectations (anticipate 0 to 5 jobs).

As shown in Figure 4 early-stage entrepreneurs with higher expectations in employment growth also need higher financial investments for their ventures. In Slovenia, early-stage entrepreneurs who anticipate higher employment growth need approximately € 15,000 which is fifty percent more than their counterparts with lower employment growth expectations. The difference between the two groups of entrepreneurs is even much more emphasized in all other groups: in all countries participating in GEM, in innovation driven economies as well as in European countries; entrepreneurs with higher employment growth expectations on average need approximately tree and a half times more financial resources as entrepreneurs with lower employment growth expectations.

The funding requirements of high-growth entrepreneurs (entrepreneurs who anticipate higher employment growth) in innovation-driven economies are substantially higher than funding requirements of high-growth entrepreneurs in efficiency- and factor- driven economies. The average amount of funding required by entrepreneurs in innovation-driven economies who anticipate the creation of six or more jobs is approximately € 70,000, compared to €10,500 for efficiency and €7,000 for factor-driven economies (Daniels et al., 2016, p. 38). As said above the difference between entrepreneurs with different expectations about employment growth are also obvious. If in the innovation-driven economies the difference between these groups of entrepreneurs is approximately 3.5, the differential is slightly smaller for efficiency-driven economies (2.5) and for factor-driven economies (2.3) (ibid).

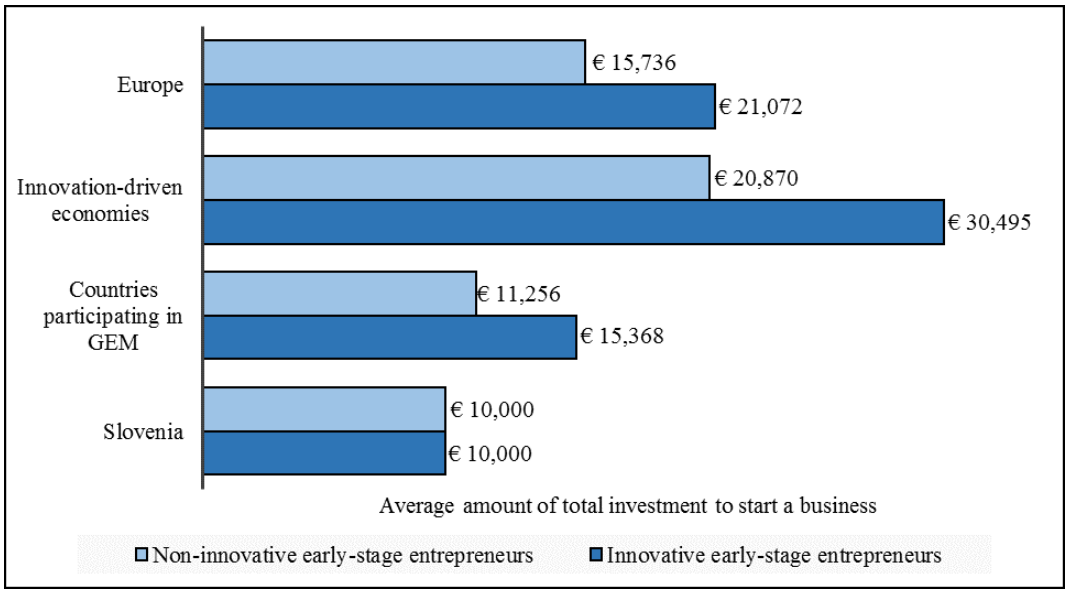


Figure 5: Average (of median) amount of total investment to start a business (in €), by innovation level of early-stage entrepreneurs in Slovenia and selected groups (Source: Rebernik et al., 2017)

In GEM research methodology innovative entrepreneurs are defined as entrepreneurs who create new products or services and who actively seeks new market niches or innovative

ways of distribution/sales channels, and therefore provide products or services that are new to the majority of potential customers and for which there is little market competition (Rebernik et al., 2017, p. 140). Thus, innovativeness is defined by tree different points of view, which are technological point of view, newness from consumers' point of view and from the view-point of the competition (Rebernik et al., 2016, p. 43).

Innovation and entrepreneurship are closely connected concepts. In Figure 5, the average (median) amounts of total investment required to start a business, according to the innovation level of early-stage entrepreneurs, are presented. As we see, in Slovenia both innovative and non-innovative early-stage entrepreneurs needed on average the same amount of financial resources to start their businesses, which is in contrary with all other groups of countries (Europe, innovative-driven economies, and GEM countries), where the innovative early-stage entrepreneurs needed on average higher financial resources to finance their ventures comparing to the non-innovative entrepreneurs. The biggest difference in the average amount of money needed by innovative entrepreneurs compared to non-innovative entrepreneurs is in innovation-driven economies, where innovative entrepreneurs needed approximately 1.5 times more funds to start their businesses. In the global perspective, the differences between the innovation levels are highest in North America and lowest in Africa (where differences between innovative and non-innovative entrepreneurs also don't exist). In North America, innovative entrepreneurs needed approximately 1.6 times more funding than non- innovative entrepreneurs, in Europe this difference was approximately 1.3, in Asia and Oceania 1.4 and in Latin America and the Caribbean 1.2 (Daniels et al., 2016, p. 40). These differences between innovative and non-innovative entrepreneurs are expected because innovativeness, especially from technological point of view, causes major financial investments.

3. CONCLUSION

The aim of this conference paper is to analyze and present some key issues of Slovenian early-stage entrepreneurs' that refer to their financial needs and decisions, in comparison with European and global entrepreneurship eco-system. To achieve this aim, the GEM research framework and database for the year 2015 were used. Slovenian early-stage entrepreneurs where compared with early-stage entrepreneurs from Europe, innovative-driven economies and from countries that were participating in GEM research project. On this basis the special chapter in Slovenian GEM report for the year 2016 (Rebernik et al., 2017) and global Special topic report (Daniels et al., 2016) were also prepared. Combining facts from these sources we have represented some of the key issues of Slovenian early-stage entrepreneurs' financial resources diversity, such as own financial resources used, average amount of financial resources needed and differences in perception of these amounts between entrepreneurs regarding their age, growth aspirations as well as regarding the innovative characteristics of their businesses. With this, our conference paper focuses on one of the key challenges of the modern entrepreneurial process, which is the issue of acquiring and obtaining of financial resources. Their availability is in fact one of the key elements in the development and in the growth process of small and medium-sized enterprises (IFC, 2011), where we can find most of the enterprises belonging to early-stage entrepreneurs. The results show and confirm previous findings about the importance of informal (and own) financial resources. As results show in Slovenia 96 % of early-stage entrepreneurs have used (at least some amount of) own financial resources to finance their ventures, which is above the European, innovation-driven countries and GEM average. The next important element of our paper is connected with the total amount of financial investment. The results show that the Slovenian early-stage entrepreneurs on average need less financial resources that their counterparts (in context of average median amount) from other compared groups.

Thus early-stage entrepreneurs from all countries which participate in GEM for the year 2015 needed approximately by 11.5 % higher financial resources as compared to the early-stage entrepreneurs from Slovenia. Early-stage entrepreneurs from Europe have approximately by 60 % higher financial needs as early-stage entrepreneurs from Slovenia. In the paper we also present the average median amounts of total investment required to start a business by age group of early-stage entrepreneurs. As described above older early-stage entrepreneurs in Slovenia perceive on average higher financial needs as their younger counterparts. This finding is partly in line with general trend that was detected on average in all countries participating in GEM research. We have also examined the average median amounts of total investment required to start a business regarding aspirations of early-stage entrepreneurs for job creation, where we have compared early-stage entrepreneurs who anticipate medium or high employment growth (anticipate six or more jobs) and early-stage entrepreneurs with lower expectations (anticipate 0 to 5 jobs). As it was shown early-stage entrepreneurs with higher expectations in employment growth also need on average higher financial investments for their ventures. This trend was detected within all comparative categories. But in Slovenia the difference between early-stage entrepreneurs with higher job-growth expectations in comparison with early-stage entrepreneurs with lower job-growth expectations was the smallest. Because the innovation and entrepreneurship are closely connected concepts we have also examined the average (median) amounts of total investment required to start a business, by innovation level of early-stage entrepreneurs. The results show that in Slovenia both innovative and non-innovative early-stage entrepreneurs needed on average the same amount of financial resources to start their businesses, which is in contrary to trends found in GEM research. Our paper represents the contribution to the understanding of Slovenian early-stage entrepreneurs' financing, since it deals with some of the key issues that Slovenian early-stage entrepreneurs face. Paper also allow us to see wider picture of Slovenian entrepreneurial ecosystem in comparison within the international context. The finding that Slovenian early-stage entrepreneurs on average more often use own financial resources as compared to other groups of countries, could indicate that Slovenian policy makers should focus their attention on enabling the access to diverse, especially external – formal financial resources. They also need to be flexible in regard to fast changes in fast changing global economy if they want to create potential for prosperity.

Limitations

This conference paper includes some important limitations. First, our paper is limited to the data from the GEM database. Although this could represent a disadvantage, due to the limitations of preselected data, we already pointed out the advantages of international comparisons' possibilities. Second, our conference paper is limited to early-stage entrepreneurs, which means that established entrepreneurs are not included into the analysis. This paper is also limited time wise and covers the situation in the year 2015.

ACKNOWLEDGMENT: *The authors acknowledge the financial support from the Slovenian Research Agency (research core funding No. P5-0023).*

LITERATURE:

1. Bewaji, T., Yang, Q. and Han, Y. (2015). Funding accessibility for minority entrepreneurs: an empirical analysis. *Journal of Small Business and Enterprise Development*, Vol. 22, No. 4, pp. 716-733.
2. Carter B., R., Van Auken, H. (2005). Bootstrap financing and owners' perceptions of their business constraints and opportunities. *Entrepreneurship & regional development*, Vol. 17, pp. 129-144.

3. Daniels, C., Herrington, M. and Kew, P. (2016). *GEM special topic report 2015-2016: Entrepreneurial finance.*
4. Eddleston A., K., Ladge J., J., Mitteness, C. and Balachandra, L. (2014). Do You See What I See? Signalling Effects of Gender and Firm Characteristics on Financing Entrepreneurial Ventures. *Entrepreneurship theory and practice*, Vol. 40, No. 3, pp. 489-514.
5. Grichnik, D., Brinckmann, J., Singh, L. and Manigart, S. (2014). Beyond environmental scarcity: Human and social capital as driving forces of bootstrapping activities. *Journal of Business Venturing*, Vol. 29, pp. 310-326.
6. IFC. (2011). *SME Finance Policy Guide*. Washington: International Finance Corporation. Retrieved 20.03.2017 from https://www.ifc.org/wps/wcm/connect/f3ef82804a02db409b88fbd1a5d13d27/G20_Policy_Report.pdf?MOD=AJPERES
7. Neeley, L., Van Auken, H. (2010). Differences between female and male entrepreneurs' use of bootstrap financing. *Journal of Developmental Entrepreneurship*, Vol. 15, No. 1, pp. 19-34.
8. Rebernik, M., Crnogaj, K., Širec, K., Bradač Hojnik, B., Rus, M. and Tominc, P. (2017). *Dynamics of Entrepreneurial Potential, GEM Slovenia 2016*. University of Maribor: University of Maribor Press.
9. Rebernik, M., Tominc, P., Crnogaj, K., Širec, K., Hojnik, B. B. and Rus, M. (2016). *Podjetništvo med priložnostjo in nujo (Entrepreneurship between opportunity and necessity), GEM Slovenija 2015*. Maribor: University of Maribor, Faculty of Economics and Business.
10. Shane, S., Cable, D. (2002). Network Ties, Reputation, and the Financing of New Ventures. *Management Science*, Vol. 48, No. 3, pp. 364-381.
11. Terjesen, S., Hessels, J. and Li, D. (2016). Comparative International Entrepreneurship: A Review and Research Agenda. *Journal of Management*, Vol. 42, No. 1, pp. 299-344.
12. Wu, Z., Chua J., H. and Chrisman J., J. (2007). Effects of family ownership and management on small business equity financing. *Journal of Business Venturing*, Vol. 22, pp. 875-895.

APPENDIX

List of European countries included in research: Belgium, Bulgaria, Croatia, Estonia, Finland, Germany, Greece, Hungary, Ireland, Italy, Latvia, Luxembourg, Macedonia, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, United Kingdom.

List of innovation-driven economies (defined by GEM): Australia, Belgium, Canada, Estonia, Finland, Germany, Greece, Ireland, Israel, Italy, South Korea, Luxembourg, Netherlands, Norway, Portugal, Puerto Rico, Slovakia, Slovenia, Spain, Sweden, Switzerland, Taiwan, United Kingdom, USA.

List of all countries participating in GEM 2015: countries from Europe and innovation-driven economies + Argentina, Barbados, Botswana, Brazil, Burkina Faso, Cameroon, Chile, China, Colombia, Ecuador, Egypt, Guatemala, India, Indonesia, Iran, Kazakhstan, Lebanon, Malaysia, Mexico, Morocco, Panama, Peru, Philippines, Senegal, South Africa, Thailand, Tunisia, Uruguay, Vietnam.

DETERMINANTS OF CUSTOMER SATISFACTION AND LOYALTY IN THE TRADITIONAL RETAIL SERVICE

Claudia Miranda Veloso
UNIAG; Institute Polytechnic of Bragança;
University of Aveiro, Portugal
cmv@ua.pt

Humberto Ribeiro
GOVCOPP; ESTGA, University of Aveiro, Portugal
humberto@alumni.dmu.ac.uk

Sandra Raquel Alves
CIC.DIGITAL; Polytechnic Institute of Leiria; ESTGF
Polytechnic of Porto, Portugal
raquel.alves.pt@gmail.com

Paula Odete Fernandes
UNIAG; Polytechnic Institute of Bragança; NECE, Portugal
pof@ipb.pt

ABSTRACT

In last decades the service quality was assumed as one of the most important factors contributing to the consumers' satisfaction. Nevertheless, there is a great misunderstanding regarding how service quality can be measured in order to enhance customer satisfaction. The quality and performance of any service are dependent on customer expectations and on the efficiency of the company to serve its customers. The crucial point of customer satisfaction is to identify the important attributes, considered by customers as their needs and expectations. The purpose of this study is to examine the suitability of SERVQUAL model methodology to evaluate the perceived quality of the service offered by traditional retail, namely in traditional retail stores in Portugal. The conceptual model proposed in this paper aims to analyse whether (1) perceived service quality (five dimensions of SERVQUAL) directly contributes to customer satisfaction, customer-perceived value and corporate image; (2) corporate image and customer-perceived value directly contribute to customer satisfaction; (3) customer--perceived value directly contribute to corporate image; (4) customer satisfaction directly influences the intention to return to store, i.e. the loyalty to staff and WOM recommendation (Word-of-Mouth communication intention); and (5) the loyalty to staff has a direct influence on the intention to return and this has a direct impact on WOM recommendation. The results suggest that service quality significantly influences corporate image, perceived value and customer satisfaction. Furthermore, the perceived value and quality service are the main determinants of customer satisfaction. Moreover, customer satisfaction, corporate image, and perceived value, significantly affect the behavioural intentions towards shopping.

Keywords: *Corporate image, Customer Loyalty, Customer Satisfaction, Quality Service, SERVPERF, SERVQUAL, Traditional Retail*

1. INTRODUCTION

Nowadays the great challenges for retail managers is to provide and sustain the customer satisfaction and their loyalty. Despite of the causes for an initial purchase in a retail store may be due to factors partially outside the control of retail managers, the ability to create a satisfactory experience for the consumer remains, to a considerable degree, in the hands of

both the management and the retail staff. It is critical for managers of traditional retail store to have a good and clear understanding of exactly what the customers want. It is also important to examine whether a retail store meets the customer needs and expectations which is measured by aspects like retail service quality, customer satisfaction and customer loyalty in the present study. Presently, providing quality of service is seen as the way to remain competitive in markets where global competition and technology have turned products and services into commodities (Nadiri and Gunay, 2013).

The traditional trade is not oblivious to customer loyalty and satisfaction with the service. In spite of most customers do not immediately associate a commercial surface with a service, the service is one of the main tools in obtaining consumer satisfaction and loyalty (Yuen and Chan, 2010). Continued aggressive promotion based in price, such as the creation of coupons, temporary discounts, and others, while widely used, often have a minimalist effect on company results, as they tend to attract the wrong customers, and this does not always mean profit (Sirohi et al., 1998). In this regard, the retail store must find a way to differentiate itself so it can stand apart from other retailers and drive more consumers to its store. Service quality is one way to accomplish this. Retailers need an efficient way to assess the service quality of their store (Simmers and Keith, 2015). However, the focus on customer retention in this area of business is one of the right strategies to generate profits (Sirohi, et al., 1998). Loyalty is an important step in ensuring that consumers perform something that is beneficial to the firm, whether through purchase or simple word of mouth (WOM). It is believed that satisfaction is a consequence of the quality of the service, and guaranteeing it, increases the likelihood of involving the customer and loyalty. Several studies have shown that there is a positive relationship between quality of service and consumer loyalty (Yuen and Chan, 2010).

The service industry is great competitive, mainly the retailing industry, wherefore is crucial that organizations have a good knowledge of the business aspects that are important to their customers (Yuen and Chan, 2010). Only with a deep understanding, is it possible to respond positively to the expectations of customers regarding the services offered. To this extent, the strategy for creating competitive advantage resides in providing a high quality of service which results in satisfied customers and customer retention, dimensions which are core for the survival of the retail industry.

Several authors have studied the relationship between perceived service quality and customer satisfaction in the services industry (Cronin and Taylor, 1992; Monteiro and Veloso, 2013; Zaibaf et al, 2012; Zhang and Prybutok, 2005), confirming that service quality is a significant antecedent of satisfaction. In this regard, Dabholkar et al (2000) argue that traditionally, most researchers conclude that customer satisfaction resulting from a particular experience of consumption, leads to an evaluation / attitude about the quality of service over a period of time. However, the reverse situation has stood out as the most relevant. Whereas the quality of service in the retail industry has been extensively researched internationally, there has been little research done in Portugal to examine service quality as a determinant of satisfaction and loyalty of customers in the Portuguese retail industry. The choice of this topic is due to the need for retailers to properly understand whether the service meets customer perceptions in the different dimensions of SERVQUAL, contribute to their satisfaction and loyalty, since they are determinant variables in maximizing profit, market share, and return on investment (Hackl and Westlund, 2000).

In this context, the central objective of this paper is to propose a methodology that allows for the examination of the antecedents and consequences of customer satisfaction, in traditional retailing sector in North of Portugal. Specifically intend to present a conceptual model is used

as a framework to identify the dimensions of service quality and examining the interrelationships among customer satisfaction, perceived value, corporate image, behavioural intentions and service quality in the traditional retail industry. In this paper, after this introduction, a review of the main literature on corporate image, perceived value, customer satisfaction and their customer loyalty is made. After it is proposed a conceptual model and research hypotheses, followed by the findings and discussion, ending with the presentation of the discussion and the conclusions of the research. This study is particularly important for retail managers (survival and growth of retail companies), politicians (wealth creation, economic growth, etc.) and for the development of the literature in the Portuguese traditional retail industry.

2. THEORETICAL BACKGROUND

2.1. Service Quality

Service quality has assumed a major role both in public and private institutions, as an indispensable requirement to the costumers' satisfaction. Firstly, it should be noted that the measurement of service quality is an important area of academic and scientific interest, which has assumed special prominence after the contribution of various authors (Parasuraman et al., 1985). These authors, who represent the American school, have designed an instrument for measuring quality of service, called SERVQUAL. Parasuraman et al., (1988) suggested the following definitions for the five dimensions: Tangibles: Physical facilities, equipment and appearance of personnel; Reliability: Ability to perform the promised service dependably and accurately; Responsiveness: Willingness to help customers and provide prompt service; Assurance: Knowledge and courtesy of employers and their ability to inspire trust and confidence; Empathy: Caring, individualized attention the firm provides its customers.

SERVQUAL measures service quality from the customer's perspective of customer perceptions, through the amplitude of the discrepancy that exists between the expectations and perceptions of customers. Cronin and Taylor (1992) view that the validity of the use of expectations in the SERVQUAL model was called into question when consumers had no well- formed expectations and developed the SERVPERF scale which consists of the same 22 "items" of SERVQUAL, although focused only in measuring consumer perceptions regarding the quality of service. Despite the criticisms of SERVQUAL (Cronin and Taylor, 1992), it remains the most widely used theoretical framework for measuring the quality of services so that, in the literature there are numerous studies that apply the SERVQUAL scale to assess quality of services across physical and in digital environments. Despite the diversity of studies in many fields, in this study, SERVPERF will be applied to the traditional trade in the North of Portugal in a similar manner as that of other studies realized at an international level, in the area of the trade industry (Abd-El-Salam, et al., 2013; Durvasula and Lysonski, 2010; Khare, et al., 2010; Martinelli and Balboni, 2012; Tang, et al., 2015; Yu and Ramanathan, 2012; Yuen and Chan, 2010). According to Nadiri and Hussain (2005) service quality increases customer satisfaction, stimuluses' intention to return, and inspires recommendations.

2.2. Customer satisfaction

Customer satisfaction is a mighty immaterial asset like to service quality and can be attained through the compliance of customer expectations (Oliver, 1999). Customer satisfaction is the outcome of the customer's perception of the value received in a transaction or relationships, where value equals perceived service quality, compared to the value expected from transactions or relationships with competing vendors (Zeithaml et al., 1990). More value for customer incomes great satisfaction, which can benefit the retail enterprise in the long term (Cronin at al., 2000) and generate higher profits. Customer satisfaction is found to be

dependent on the quality of service presented to the customer and is one of the instruments to enhanced value for customers. The major challenges for service industry are service quality and customer satisfaction. According to Gundersen et al. (1996) the central point of customer satisfaction is to identify the crucial attributes, considered by customers as their needs and expectations. As Valdani (2009) points out, enterprises exist because they have a customer to serve. The key to customer satisfaction lies in identifying and anticipating customer needs and especially in being able to satisfy them. Enterprises which are able to rapidly understand and to satisfy customers' needs, make greater profits than those which fail to understand and satisfy them (Dominici and Guzzo, 2010).

In order to be successful, especially in the service industry, managers must concentrate on retaining existing customers by implementing effective strategies towards customer satisfaction and loyalty, since the cost of attracting new customers is higher than the cost of retaining existing (Dominici and Guzzo, 2010). On the other hand Bennett and Rundle-Thiele (2002), argued that for customers to escalate their loyalty, their perceived value of the good or service presented need be at par with reality, forming an integral part of the corporate aims of the organization. Additionally, Sirdeshmukh, et al. (2002), reported that customers' satisfaction has close relationship to brand loyalty as well as service quality. Analogous claim is presented by Hoq and Amin (2010), who postulated that customer satisfaction is the emotional tendency of a customer towards repurchase of products and services offered by a retail store. In order to be successful, especially in the retail industry, managers must concentrate on retaining existing customers by implementing effective strategies towards customer satisfaction and loyalty, since the cost of attracting new customers is higher than the cost of retaining existing ones (Yuen and Chan, 2010).

2.3. Corporate Image

Several researchers of the area of marketing have widely studied the concept of brand image (Abd-El-Salam, et al., 2013; Kim and Kim, 2005; Kim and Lee, 2010; Sahin and Baloglu, 2011; Yu and Ramanathan, 2012). For Kim and Kim (2005) a brand symbolizes the essence of the customers' perceptions of the organizations. Corporate image is defined as the "general impression" left in the customers' mind as a result of accumulative impressions or feelings, attitudes, ideas and experiences with the firm, saved in memory, transformed into a positive/negative sense, retrieved to rebuilding image and recalled when the name of the firm is heard or brought to ones' mind. According to Sahin and Baloglu (2011) corporate image is defined as the perception of customers about a brand or a product labelled with that brand. Different authors consider brand image as an important component of strong brands and a determinant in the obtainment of competitive advantages.

An overall assumption is that a promising corporate image will have a positive impact on consumers' behaviour towards the brand, such as the opportunity to command premium prices, buyers who are more loyal, and more positive word-of-mouth reputation (Martenson, 2007). Some researchers developed in last years, have tested the effect of corporate image on customer satisfaction and loyalty (Kim and Lee, 2010; Yu and Ramanathan, 2012). Their empirical findings showed that corporate image plays the important role in founding and retaining customer loyalty in the markets. Additionally, these authors found that customer satisfaction and corporate image perceptions positively influence service loyalty, with satisfaction having a greater influence on loyalty than image. Thus, corporate image is believed to create a positive effect on customers' satisfaction. When customers are satisfied with the service provided of company, their attitude toward the company is enhanced (Srivastava & Sharma, 2013).

2.4. Perceived Value

Currently, the traders are more concerned with the pricing strategy attached the effectiveness and the competitiveness of the market. A broad pricing model is largely a crucial requirement for achieving a unique corporate success, this argument has been supported by many researchers. These authors proved that the application of a pricing strategy improves the volume of sales and profit margin. According to Matzler et al., (2006) the pricing strategy is a main determinant to strengthen and improve the customers' satisfaction and loyalty, indeed in the retail industry, the pricing strategy and the value perceived is as much or even more important than the perceived service quality in the corporate strategy. Therefore, it can be contended that a suitable pricing model and a favourable perceived value positively strengthen the business's global success in the retail industry (Nikhashemia et al., 2014). Some research have also related that perceived value variation has beyond the close relationship with quality service adopts a significant relationship with product delivery and customers' expectations and loyalty. Several authors have also found numerous perceived value influences on quality service. This does not mean that the perceived value will have be low to exist satisfaction, but that the value perceived by the customer will take into account the received and its relationship with the price paid. Previous studies on goods have showed that the perceived value relationship was considered enough important for customer satisfaction (Qin and Prybutok, 2008).

2.5. Customer Loyalty

Customers frequently develop an attitude toward purchasing based on a prior service experience or, still, this attitude can also be influenced by previous information, based on the image of the retail in the market and even by word of mouth (WOM recommendation). With reference to the previous conception, customer loyalty has been usually defined as occurring when customers repetitively buying goods or services over time and retain positive attitudes towards the enterprise delivering the goods or services (Yuen and Chan, 2010). Service providers are increasingly developing loyalty, as they consider that it helps to rise income, and leads to largest market share, effectiveness and profitability (Al-Wugayan et al., 2008). The literature suggests behavioural intentions as a construct which permits the evaluation of customer loyalty. These are behaviours related to the intention to repurchase and even to the intention of recommending the product/service (Sumaedi and Yarmen, 2012; Yuen and Chan, 2010; Zeithaml, et al., 1990). Some studies developed in service industry have found the positive relationship between perceived service quality and loyalty (Wong et al., 1999). In this sense, behavioural intentions can be define as the customer's judgment about the likeliness to repurchase in this firm or the willingness to recommend the firm to others. We conceptualize behavioural intentions as a higher-order construct consisting of (1) positive word of mouth (Boulding et al., 1993), (2) willingness to recommend (Parasuraman et al., 1991), and (3) intentions to continue buying from a particular service provider (Bowen and Shoemaker, 1998). Based on previous definition, behavioural intention in this study may be described as a stated likelihood to repurchase in the retail stores in the North of Portugal and to recommend the traditional store to family, friends and others in the future. Research has established the many benefits of behavioural intention, such as making it a tendency for retailers to follow, as well as developing and maintaining a loyal customer base (Yuen and Chan, 2010). There is also ample evidence of the influence of service quality on behavioural intentions, a huge body of research has demonstrated the significant relationship between service quality and customers' behavioural intentions (Parasuraman et al., 2005; Sousa and Voss, 2010). Zeithaml at al., (1996), compiled a list of specific positive behavioural intentions, included loyalty, switching intentions, willingness to pay more, external response, and internal response. In a multi-industry study, the authors later provided evidence of the

significant effect of perceived service quality on customers' favourable behavioural intentions, such as repurchase, tendency to say positive things and recommend the company. In addition Cronin and Taylor (1992), find a favourable association between service quality and repurchase intentions. Also, Zeithaml, et al., (1996) and Fullerton (2005), find a positive relationship between service quality and behavioural intentions. Moreover, preceding research has demonstrated associations between service quality and particular dimensions of behavioural intentions, like as Parasuraman, et al. (1988), find a favourable relationship between service quality and willingness to recommend the firm, and Boulding, et al., (1993), find a positive correlation between service quality and repurchase intentions, saying positive things, and willingness to recommend. Therefore, we expect customers who perceive the quality of the service as high to be more likely to demonstrate intentions, and we again believe that this relationship will hold regardless of the buyers' collectivist orientation. Loyal customers are main assets to firms, they make proportionally more purchases at their' first choice' store than customers who shift (Knox and Denison, 2000). Usually, great service quality leads to customer loyalty, as it increases customer confidence towards and satisfaction with the company. It is supposed that positive perceptions of service quality enhances the possibility of customers being dedicated in supporting the company and developing and strengthening loyalty behaviour (Yuen and Chan, 2010).

3. CONCEPTUAL RESEARCH MODEL AND HYPOTHESES

According to this theoretical background, the aim of this study is to propose a model that consists of evaluating the impact of: (1) perceived service quality directly contribute to customer satisfaction, customer-perceived value and corporate image; (2) corporate image and customer-perceived value directly contribute to customer satisfaction; (3) customer-perceived value directly contribute to corporate image; (4) customer satisfaction directly influences the intention to return, the loyalty to staff and WOM recommendation (Word-of-Mouth communication intention) and (5) the loyalty to staff has a direct influence on the intention to return and this has a direct impact on WOM recommendation.

The retail managers should focus their attention on customer service quality evaluation as they must have actual knowledge that the service quality perceived by the client meets their expectations, as contended by Parasuraman et al., (1985, 1988). Based on these assumptions the purpose of this study is to examine whether the perception of the services provided in the different dimensions of SERVQUAL, exceeds the customer expectations. However, the main objective of this study is to test the conceptual model shown in Figure 1, which includes eleven research hypotheses, as explained below.

Several authors have considered service quality as an important antecedent of satisfaction (Cronin and Taylor, 1992; Mahfooz, 2014; Martinelli and Balboni, 2012; Nikhashemia, et al., 2014; Yuen and Chan, 2010; Zhang and Prybutok, 2005). Most studies assessing the relationship of service quality on customer satisfaction demonstrate the existence of a statistically significant level in studies of the service industry. Moreover, the literature suggests that perceived service quality positively influences perceived brand image (Oh, 1999; Yu and Ramanathan, 2012) and the perceived value (Howat and Assaker, 2013; Nikhashemia, et al., 2016; Ryu et al., 2008). In line with this, and based on SERVQUAL, the following model and hypotheses are proposed in the present study.

Figure following on the next page

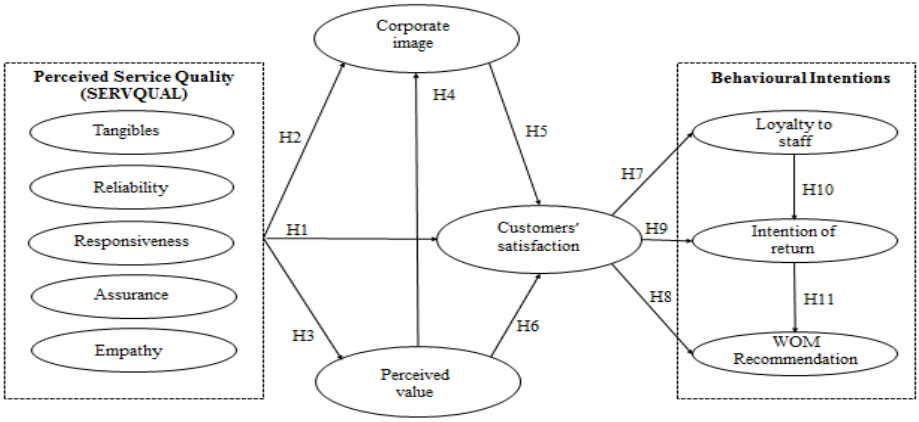


Figure 1: Research model

***H1**: The quality perceived by the customers has a positive influence on their satisfaction.*
***H2**: The perceived service quality by the customers has a positive influence on perceived corporate image.*
***H3**: The perceived service quality by the customers has a positive influence on perceived value.*
The study of image has received increasing attention in the literature on marketing (Ryu et al., 2008; Wu et al., 2011), since it affects the individual´s subjective perception. In the area of service industry, Hsin-Hui et al., (2009) confirm that the perceived value of a hotel positively and significantly influences the corporate image. Thus, this study proposes the following hypothesis:
***H4**: The perceived value has a positive influence on the corporate image.*
The relationship between image and perceived value on customer satisfaction has gained little attention in the services industry literature (Ryu et al., 2008). These authors have evaluated the impact of the image of a restaurant and perceived value on customer satisfaction and they found a positive and significant relationship between these constructs. In the area of retail industry, Yu and Ramanathan (2012) confirm that the corporate image of a retail store positively and significantly influences customer satisfaction. In this sense, we intend to propose the following hypotheses:
***H5**: The perceived brand image by the customers has a positive influence on their satisfaction.*
***H6**: The perceived value by the customers has a positive influence on their satisfaction.*
In reviewing the literature, we have found that marketing services have extensively researched behavioural attitudes. These are behaviours related to the intention to repurchase and even to the intention of recommending the product/service (Sumaedi and Yarmen, 2012; Yuen and Chan, 2010; Zeithaml, et al., 1990). Several concepts have been examined as antecedent factors of behavioural intentions, such as service quality (Zeithaml et al., 1996) and satisfaction (Oliver, 1999). According to Liang and Zhang (2012, p. 156), "*it is generally believed that satisfaction leads to repeat purchases and positive WOM recommendations*", assuming that if customers are satisfied with a product/service, they are more likely to continue to purchase it, and are more willing to spread positive WOM. Thus, we propose our seventh, octave and ninth hypotheses:
***H7**: Customer satisfaction positively influences intention to return.*
***H8**: Customer satisfaction positively influences WOM recommendations.*
***H9**: Customer satisfaction positively influences loyalty to staff.*

According to Nadiri and Hussain (2005, p 471), "service quality promotes customer satisfaction, stimulates intention to return, and encourages recommendations". Oh (1999) found a positive and significant relationship between intention to return and WOM recommendations. Yuen and Chan (2010) approve a positive and significant relationship between loyalty to staff and intention to return. In this study we intend to uphold the following hypothesis:

H10*: Loyalty to staff positively influences intention to return.*

H11*: Intention to return positively influences WOM recommendations.*

4. METHODOLOGY

A questionnaire was designed as the survey instrument, which were included all the constructs of the proposed model. The questions in the questionnaire were based on a review of the literature in the area of the trade industry, described above in the theoretical background. This study was applied to customers from of traditional retail stores in the north of Portugal during the month of February, 2017. It was used a non-probabilistic sampling using convenience technique. The questionnaires were distributed online and the answers came from several cities and places of the north of Portugal. In this study, respondents were required to fill out a three-page three sections. The first section consisted of a standard demographic profile of respondents. The second section contained the characterization of purchase process. The last section includes the statements of dimensions and their sub dimensions. The measurement items to measure primary and sub-dimensions of service quality were adapted from several researchers (Cronin and Taylor, 1992; Dabholkar et al., 1996; Wu et al., 2011) and a series of items focusing on the behavioural intentions, customer satisfaction, perceived value and corporate image, which were adapted on the basis of several researchers' results (Nadiri and Gunay, 2013; Nikhashemia et al., 2016; Ryu et al., 2008; Wu, et al., 2011; Wu, 2013; Yu and Ramanathan, 2012; Yuen and Chan, 2010; Zeithaml et al., 1996). Respondents were asked to use a five-point Likert-type scale (where 5–point scales anchored 1 = "strongly disagree" and 5 = "strongly agree") to record their perceptions. Construct reliability was assessed by using the Cronbach's alpha coefficient. Reliabilities ranged from 0.832 to 0.965, suggesting that the construct could be used with confidence. For the descriptive analysis it was used absolute and relative frequency tables. The Spearman correlation coefficient it was used to measure the intensity of the linear correlation between variables. Multiple linear regression was used in order to estimate models that could identify the determinants of the behaviour of the variables under analysis. The significance level of 5% was assumed.

5. DATA ANALYSIS AND FINDINGS

5.1. Demographic Profile

The sample of the North of Portugal was composed of total 211 respondents which 58.3% (123) were females and 41.7% (88) were males. The maximum number of responses was obtained from 35 - 44 years old with 43.1% (91) and the second age group from 45 - 54 years, with 28% (59) responses. Most respondents 66.8% (141), were married or in an unmarried partner, 23.2% (49) were single. It is verified most of respondents had higher education qualifications, as 33.2% (70) were graduates; 10.4% (30) had postgraduate degrees; 14.2% (30) had a master's degree and 12.3% (26) were PhDs. As for the professional occupation mostly, 78.2% (165) were employed. In the activity sector, banking stood out with 34.1% (72) of the respondents, followed by education sector with 17.1% (36) of the individuals. Regarding the average annual income, it is observed that 28% (59) of the respondents earned between 7001€ to 20000€; 29.9% (51) earned between 20001€ to 40000€ and 21.3% (45) received annually between 40001€ to 80000€.

5.2. Purchase Process

The obtained results show that 98.1% (207) of the respondents purchases in traditional trade. It was verified that 74.4% (157) of the individuals had made purchases in traditional trade there is more than 12 months. The most popular frequency of purchases registered was monthly, 33.6% (71) of the respondents go to the traditional trade once a month and 32.2% (68) do it weekly. As for the average annual spending on purchases in the traditional trade, it was found that 30.3% (64) of the respondents spend under 100€ and that 39.8% spend more than 400€ annually.

5.3. Correlation and Regression Analyses

Analysing the 0 shows that the sub-dimensions that constitute Service Quality (SQ) present strong and direct correlations with the SQ, namely reliability, responsiveness and empathy sub-dimensions with very strong correlation coefficients.

Table 1: Spearman correlations between SQ and its constituent dimensions

Dimensions	Service Quality
Tangibles	0,828
Reliability	0,938
Assurance	0,895
Responsiveness	0,939
Empathy	0,935

The 0 shows that the dimensions that constitute Customer Loyalty present strong and direct correlations with the same, namely the dimensions: Wow and intention to return. The staff loyal contributes least to the behavioural intentions (customer loyalty).

*Table 2: Spearman's correlation between Customer Loyalty and its constituent dimensions (** 1% significant level)*

Dimensions	Customer Loyalty
WOM	0,891**
Intention to Return	0,943**
Loyalty to Staff	0,787**

In the Table 3 it is verified that all scale dimensions have positive statistically significant correlation coefficients. The correlation between Service Quality and Customer Satisfaction is strong; as well as between Perceived Value versus Service Quality and Customer Satisfaction; and between Customer Loyalty versus Service Quality, Customer Satisfaction and Perceived Value. However, the correlations of the corporate image dimension with the other dimensions were of moderate intensity.

Table 3: Spearman correlation between dimensions of scale

	Service Quality	Customer Satisfaction	Perceived value	Customer Loyalty	Image
Service Quality	1	0,807**	0,712**	0,740**	0,607**
Customer Satisfaction		1	0,763**	0,792**	0,545**
Perceived value			1	0,747**	0,474**
Customer Loyalty				1	0,635**
Image					1

Ordinary least squares regression was used to analyse each path in the conceptual model. Statistical assumption tests were assessed for each of the six regression models prior to the analysis in order to ensure a robust result. The results of the hypotheses testing are presented in Table 4 and Table 5. The application of the multiple linear regression model allowed to obtain a parsimonious model that makes it possible to predict the dependent variable from a set of regressors (independent variables). Table 4, below, offers a summary of the regressions made.

Table 4: Summary of regression models

Dependent variable	Independent variables	Adjusted R^2	*F* value (p value)	Standardized coefficients	*t* value (p value)
Customer Satisfaction	Service Quality	0,775	237,493 (0,000)	0,432***	9,428(<0,001)
	Perceived value			0,218***	7,236(<0,001)
	Image			0,074	1,711(0,089)
Wom	Customer Satisfaction	0,802	168,157 (0,000)	0,151***	2,198(0,029)
	Service Quality			0,214***	3,394(0,001)
	Perceived value			0,302***	5,590(<0,001)
	Image			-0,180***	-3,781(<0,001)
	Intention to Return			0,454***	7,607(<0,001)
Intention to Return	Customer Satisfaction	0,725	136,669 (0,000)	0,327***	4,214(<0,001)
	Service Quality			0,037	0,495(0,621)
	Perceived value			0,218***	3,523(0,001)
	Loyalty to staff			0,400***	8,265(<0,001)
Loyalty to Staff	Customer Satisfaction	0,428	31,845 (0,000)	0,240***	2,053(0,041)
	Service Quality			-0,106	-0,987(0,325)
	Perceived value			0,033	0,359(0,720)
	Image			0,107	1,330(0,185)
	Intention to Return			0,438***	4,320(<0,001)
Customer Loyalty	Customer Satisfaction	0,780	183,978 (0,000)	0,366***	5,274(<0,001)
	Service Quality			0,094	1,421(0,157)
	Perceived value			0,301***	5,434(<0,001)
	Image			0,246***	5,682(<0,001)
Image	Service Quality	0,417	74,574 (0,000)	0,585***	3,643(0,000)
	Perceived value			0,084	1,042(0,299)
Perceived value	Customer Satisfaction	0,648	190,993 (0,000)	0,569***	7,346(<0,001)
	Service Quality			0,267***	3,446(<0,001)

In the first regression model which tests the influence of service quality, corporate image and perceived value on the variation of customer satisfaction is tested. The model obtained is at a statistically significant level of significance of 1% (F = 237,493; p-value = 0,000), that is, the variation of customer satisfaction is explained significantly by the estimated model. By the application of the test t, we conclude that service quality (β = 0,527; p-value < 0,01) and perceived value (β = 0,361; p-value <0,01) determine significantly the behaviour of customer satisfaction. The Corporate Image regression does not present a statistically significant influence on the variation of customer satisfaction. The adjusted coefficient of determination reveals that the model presented explains, on average, about 77,5% of the variation of customer satisfaction. Consequently, this model supports the first and the sixth hypothesis and refutes the fifth hypothesis. The second regression model that relates WOM with the regressors: customer satisfaction, service quality, perceived value, corporate image and intention to return is at a significance level of 1% statistically significant. The determinants of the model influenced significantly the variation of WOM, as the test t, customer satisfaction with coefficient (β = 0,151 and p-value <0,05; service quality (β=0,214; p values<0,01); intention to return with coefficient (β = 0,454 and p-value <0,01); perceived value with coefficient (β = 0,302 and p-value <0,01); corporate image with coefficient (β = -0,181 and p-value <0,01); are statistically significant. The estimated model explains, on average, about 80,2% of the WOM variation. Thus, this model supports the octave and the tenth hypothesis.

In the third regression model that relates intention to return with the regressors: customer satisfaction, service quality, perceived value and loyalty to staff is at a significance level of 1% statistically significant. The followings determinants of the model influenced significantly the variation of intention to return, as the test t, customer satisfaction with coefficient ($\beta = 0,327$ and p-value <0,01), perceived value ($\beta = 0,218$ and p-value <0,01) and loyalty to staff with coefficient ($\beta = 0,400$ and p-value <0,05) are statistically significant. The estimated model explains, on average, about 72,5% of the intention to return. The service quality regressor is not presented significantly in the variation of intention to return. Thus, this model supports the seventh and eleventh hypothesis.

The fourth regression model that relates loyalty to staff with the regressors: customer satisfaction, service quality, perceived value, corporate image and intention to return is at a significance level of 1% statistically significant. The estimated model explains, on average, about 42,8% of the loyalty to staff. The followings determinants of the model influenced significantly the variation of loyalty to staff, as the test t, customer satisfaction with coefficient $\beta = 0,240$ and p-value <0,05 and intention to return with coefficient $\beta = 0,438$ and p-value <0,01; are statistically significant. The service quality, perceived value and corporate image regressors are not presented significantly in the variation of loyalty to staff. Thus, this model supports the ninth hypothesis.

The fifth regression model that relates customer loyalty with the regressors: customer satisfaction, service quality, perceived value and corporate image is at a significance level of 1% statistically significant. The determinants of the model influence significantly the variation of customer loyalty, because by the test t customer satisfaction with coefficient $\beta = 0,366$ and p-value <0,01; perceived value with coefficient $\beta = 0,308$ and p-value <0,01; corporate image with coefficient $\beta = 0,246$ and p-value <0,01; are statistically significant. The service quality regressor is not presented significantly in the variation of customer loyalty. The estimated model explains, on average, about 78% of the customer loyalty variation.

In the sixth regression model which tests the influence of service quality and perceived value on the variation of corporate image is tested. The estimated model explains, on average, about 41,7% of the corporate image variation. By the application of the test t, the service quality with coefficient $\beta = 0,58\%$ and p-value <0,01, can be conclude that, determines significantly corporate image behaviour. The perceived value regressor is not presented significantly in the variation of corporate image. Therefore, this model supports the second hypothesis and refutes the fourth hypothesis.

The seventh regression model that relates perceived value with the regressors: service quality and customer satisfaction, is at a significance level of 1% statistically significant. The estimated model explains, on average, about 64,8% of the perceived value variation. By the application of the test t, the service quality with coefficient $\beta = 0,267$ and p-value <0,001 and customer satisfaction with coefficient $\beta = 0,569$ and p-value <0,001, can be conclude that, determines significantly perceived value behaviour. Therefore, this model supports the third hypothesis. Table 5, shown below, resumes the results obtained for the hypotheses testing.

Table following on the next page

Table 5: Hypothesis test results

Hypotheses	Preposition	*Hypothesis supporting*
H1	The perceived service quality by the customers has a positive influence on their satisfaction	Supported
H2	The perceived service quality by the customers has a positive influence on the corporate image	Supported
H3	The perceived service quality by the customers has a positive influence on the perceived value	Supported
H4	Perceived value has a positive influence on the corporate image	Not Supported
H5	The corporate image has a positive impacts on customer satisfaction	Not Supported
H6	Perceived value has a positive influence on the customers' satisfaction	Supported
H7	Customer satisfaction positively influences intention to return	Supported
H8	Customer satisfaction positively influences WOM recommendations.	Supported
H9	Customer satisfaction positively influences loyalty to the staff.	Supported
H10	Intention to return positively influences WOM recommendations	Supported
H11	Staff Loyalty positively influences Intention to return	Supported

6. DISCUSSION AND CONCLUSIONS

The objective of this study was to identify the dimensions of service quality and examining the interrelationships among customer satisfaction, corporate image, perceived value, service quality and customer loyalty in traditional trade. In addition to investigate the customer satisfaction, the perceived service quality, the perceived value and the corporate image as determinants of the customer loyalty in the traditional commerce in the North of Portugal. So, the model proposed was allowed to evaluate the hypotheses presented, as well as it contributes to the retail managers better understand the implications of the dimensions of service quality, of perceived value, of corporate image on the customer satisfaction and on behavioural intentions, and the consequently on the profitability of the retail stores. The results from exploratory factor analysis indicate that service quality consists of five dimensions (tangibles, reliability, responsiveness, assurance and empathy). For traditional retail in the North of Portugal, reliability; responsiveness and empathy play an important role in determining service quality, and are followed by assurance and tangibles. The findings of this study demonstrate that service quality has a direct influence on corporate image, which in turn, influence customer loyalty. The positive relationship between service quality and corporate image suggests that customers who received high service quality during service delivery would form a favourable image of the traditional retail store. Nonetheless, the corporate image does not influences directly the customer satisfaction, thus, H5 is not supported. However, increased service quality then results in greater corporate image that results indirectly in greater customer loyalty, based on the positive relationship between image and customer loyalty. Furthermore, the study showed that the service quality and perceived value are determinants of customer satisfaction and this is indirectly influence customer loyalty. The level of satisfaction of the customers positively affects their word of communication about traditional stores retail of the north of Portugal, their loyalty to employers and the customers' intentions to revisit these stores. Findings found are also consistent with the literature. In other researches such as this, satisfied customers have higher levels of intention for revisiting traditional stores of the north of Portugal, loyal customer to staff has intention to revisit the traditional retail store and their satisfaction levels induce them to provide positive word of mouth communication to friends or families. This research contributes to the development of the literature, politicians (wealth creation, economic growth, etc.) and managers of traditional retail stores (the survival and growth of traditional trade). From a practitioners' point of view, the understanding of the factors that influence customers´ satisfaction and behavioural intentions, on the one hand, may contribute to the retail manager's development when establishing strategies and contribute to

the improvement of services provided by the traditional retail stores and consequently increase profit, market share, and improve return on investment (Hackl and Westlund, 2000). Findings of the corporate image, perceived value and of the dimensions of service quality and of it relative importance can provide useful insights for how managers and owned should allocate resources in the traditional retail stores. Also, traditional trade management should structure their infrastructure, processes, operations and resource allocation in terms of the relative importance of the service quality dimensions to their target at specific customers. Retail service providers need to recognize the importance of service quality dimensions in order of their significance, and implement appropriate strategy for competitive advantage over domestic and international players competing for share of an expanding consumer base (Mahfooz, 2014). Additionally, it was showed that improving customers' perceptions of service quality can effectively increase satisfaction levels through high levels of value perceived. In this way, the findings of this study can aid retail management to identify that both customer satisfaction and value perceived and also, the corporate image directly affect customer loyalty. Consequently, store management should make more effort to increase perceptions of satisfaction, of corporate image and of value perceived that gives to the market, whether through communication actions or interaction with society where operate, in order to build the favourable customers' behavioural intentions.

ACKNOWLEDGEMENT: *This work was financially supported by the research unit on Governance, Competitiveness and Public Policy (project POCI-01-0145-FEDER-006939), funded by FEDER funds through COMPETE2020 - Programa Operacional Competitividade e Internacionalização (POCI) – and by national funds through FCT - Fundação para a Ciência e a Tecnologia.*

LITERATURE:

1. Abd-El-Salam, E. M., Shawky, A. Y., & El-Nahas, T. (2013). The impact of corporate image and reputation on service quality, customer satisfaction and customer loyalty: testing the mediating role. Case analysis in an international service company. *Journal of Business and Retail Management Research, 8(1)*, 130-153.
2. Al-Wugayan, A., Pleshko, L. P., & Baqer, S. M. (2008). An investigation of the relationships among consumer satisfaction, loyalty, and market share in Kuwaiti loan services. *Journal Of Financial Services Marketing, 13(2)*, 95-106.
3. Bennett, R., & Rundle-Thiele, S. (2002). A comparison of attitudinal loyalty measurement approaches. *The Journal of Brand Management, 9(3)*, 193-209.
4. Boulding, W., Kalra, A., Staelin, R., & Zaithaml, V. A. (1993). A dynamic process model of service quality: From expectations to behavioral intentions. *Journal of Marketing Research, 30(1)*, 7-27.
5. Bowen, J. T., & Shoemaker, S. (1998). Loyalty: A strategic commitment. *Cornell and Hotel Restaurant Administration Quarterly, 39(1)*, 12-25.

6. Cronin, J., Brady, M. K., & Hult, G. T. (2000). Assessing the effects of quality, value, and customer satisfaction on consumer behavioral intentions in service environments. *Journal of Retailing, 76(2)*, 193-218.
7. Cronin, J., & Taylor, S. (1992). Measuring service quality: a reexamination and extension. *Journal of Marketing, 56 (3)*, 55-68.
8. Dabholkar, P. (1996). Consumer evaluations of new technology-based self-service operations: an investigation of alternative models. *International Journal of Research in Marketing, 13 (1)*, 29-51.
9. Dabholkar, P., Shepherd, D. & Thorpe, D. (2000). A comprehensive framework for service quality: An investigation of critical conceptual and measurement issues through a longitudinal study. *Journal of Retailing, 76 (2)*, 139-173.
10. Dominici, G., & Guzzo, R. (2010). Customer satisfaction in the hotel industry: a case study from Sicily. *International Journal of Marketing Studies, 2(2)*, 3-12.
11. Durvasula, S., & Lysonski, S. (2010). Diagnosing service quality in retailing: the case of Singapore. *Journal International Business and Entreprenurship Development, 5 (1)*, 2-17.
12. Fullerton, G. (2005). The impact of brand commitment on loyalty to retail service brands. *Canadian Journal of Administrative Sciences, 22(2)*, 97-110.
13. Gundersen, M. H., & Olsson, U. (1996). Hotel guest satisfaction among business travelers: what are the important factors? *The Cornell Hotel and Restaurant Administration Quarterly, 37 (2)*, 72-81.
14. Hackl, P., & Westlund, A. (2000). On structural equation modeling for customer satisfaction measurement. *Total Quality Management, 11 (4/5/6)*, S820–S825.
15. Hsin-Hui, H., Jay, K. & Thanika, D. J.(2009). Relationships and impacts of service quality, perceived value, customer satisfaction, and image: an empirical study. *The Service Industries Journal*, 29 (2), 111-125.
16. Hoq, M. Z., & Amin, M. (2010). The role of customer satisfaction to enhance customer loyalty. *African Journal of Business Management, 4(12)*, 2385-2392.
17. Howat, G., & Assaker, G. (2013). The hierarchical effects of perceived quality on perceived value, satisfaction, and loyalty: empirical results from public, outdoor aquatic centres in Australia. *Sport Management Review, 16 (3)*, 268-284.
18. Khare, A., Parveen, C., & Rai, R. (2010). Retailer behavior as determinant of service quality in Indian retailing. *Journal of Retail & Leisure Property, 9 (4)*, 303-317.
19. Kim, H.-B., & Kim, W. (2005). The relationship between brand equity and firms performance in luxury hotels and chain restaurants. *Tourism Management, 26*, 549-560.
20. Kim, Y.-E., & Lee, J.-W. (2010.). Relationship between corporate image and customer loyalty in mobile communications service markets . *Africa Journal of Business Management,, 4(18)*, 4035-4100.
21. Knox, S. D., & Denison, T. J. (2000). Store loyalty: Its impact on retail revenue. An empirical study of purchasing behaviour in the UK. *Journal of Retailing and Consumer Services, 7(1)*, 33-45.
22. Liang, R., & Zhang, J. (2012). The effect of service interaction orientation on customer satisfaction and behavioral intention: the moderating effect of dining frequency. *Asia Pacific Journal of Marketing and Logistics, 24 (1)*, 153-170.
23. Mahfooz, Y. (2014). Relationship between Service Quality and Customer Satisfaction in Hypermarkets of Saudi Arabia. *International Journal of Marketing Studies, 6 (4)*, 10-22.
24. Martenson, R. (2007). Corporate brand image, satisfaction and store loyalty: A study of the store as a brand, store brands and manufacturer brands. *International Journal of Retail & Distribution Management 35, no. 7: 544–55., 35(7)*, 544-555.

25. Martinelli, E., & Balboni, B. (2012). Retail service quality as a key activator of grocery store loyalty. *The Service Industries Journal, 32(14)*, 2233-2247.
26. Matzler, K., Bidmon, S., & Grabner-Kräuter, S. (2006). Individual determinants of brand affect: the role of the personality traits of extraversion and openness to experience. *Journal of Product & Brand Management, 15 (7)*, 427-434.
27. Monteiro, A., & Veloso, C. (2013). Measuring service quality, brand image, perceived value, customers' satisfaction and behavioural intentions in the hotel industry: a study of the hotel in the North of Portugal. *6th Annual EuroMed Conference of the EuroMed Academy of Business* (pp. 1568-1582). Cascais, Portugal: ISBN: 978-9963-711-16-1.
28. Nadiri, H., & Gunay, N. (2013). An emperical study to diagnose the outcomes of customers' experiences in trendy coffee shops. *Journal of Business Economics and Management, 14 (1)*, 22-53.
29. Nadiri, H., & Hussain, K. (2005). Perceptions of service quality in North Cyprus hotels. *International Journal of Contemporary Hospitality Management, 17 (6/7)*, 469-480.
30. Nikhashemia, S. R., Paim, L. H., Sidin, M., S., & A., K. (2014). Driving Forces of Hypermarket's Customer Loyalty: An Empirical Study in Malaysia. *Australian Journal of Basic and Applied Sciences, 8(3)*, 377-386.
31. Nikhashemia, S. R., Tarofderb, A. K., Gaura, S. S., & Haque, A. (2016). The Effect of Customers' Perceived Value of Retail Store on Relationship between Store Attribute and Customer Brand Loyalty: Some Insights from Malaysia. Fifth International Conference On Marketing And Retailing.
32. Oh, H. (1999). Service quality, customer satisfaction, and customer value: A holistic perspective. *International Journal of Hospitality Management, 18 (1)*, 67-82.
33. Oliver, L. (1999). Whence consumer loyalty? . *Journal of Marketing, 63 (4)*, 33-44.
34. Parasuraman, A., Zeithaml, V., & Berry, L. (1985). A conceptual model of service quality and its implications for future research. *Journal of Marketing, 49(1)*, 41-50.
35. Parasuraman, A., Zeithaml, V., & Berry, L. (1988). SERVQUAL: A multiple-item scale for measuring consumer perceptions of service quality. *Journal of Retailing, 64(1)*, 12-40.
36. Parasuraman, A., Zeithaml, V. A., & Berry, L. (1991). Refinement and reassessment of the SERVQUAL scale. *Journal of Retailing, 67(4)*, 420-450.
37. Parasuraman, A., Zeithaml, V., & Malhorta, A. (2005). E-S-QUAL: a multiple-item scale for assessing electronic service quality. *Journal of Retailing, 64(1)*, 12-40.
38. Qin, H., & Prybutok, V. (2008). Determinants of customer-perceived service quality in fast food restaurants (FFRs) and their relationship to customer satisfaction and behavioural intentions. *Quality Management Journal, 15(2), 35-50., 15(2)*, 35-50.
39. Ruy, K., Han, H., & Kim, T.-H. (2008). The relationships among overall quick-casual restaurant image, perceived value, customer satisfaction, and behavioral intentions. *Management Hospitality, 27*, 459-469.
40. Sahin, S., & Baloglu, S. (2011). Brand personality and destination image of Istanbul. *An International if Tourism and Hospitality Research, 22(1)*, 69-88.
41. Simmers, C., & Keith, N. (2015). Measuring retail store service quality: the disparity between the retail service quality Scale (RSQS) and Comment Cards. *International Academy of Marketing Studies Journal, 19 (2)*, 117-126.
42. Sirdeshmukh, D., Singh, J., & B., S. (2002). Consumer trust, value, and loyalty in relational exchanges. *The Journal of Marketing, 66(January)*, 15-37.

43. Sirohi, N., McLaughlin, E. W., & Wittink, D. R. (1998). A model of consumer perceptions and store loyalty intentions for a supermarket retailer. *Journal of Retailing*, 223 - 245.
44. Sousa, R., & Voss, C. (2010). The impacts of e-service quality on customer behavior in multi-channel e-services. *Total Quality Management & Business Excellence, 23(7/8)*, 769-787.
45. Srivastava, K., & Sharma, N. (2013). Service Quality, Corporate Brand Image, and Switching Behavior: The Mediating Role of Customer Satisfaction and Repurchase Intention. *Services Marketing Quarterly, 13*, 274–291.
46. Sumaedi, S., Bakti, I., & Yarmen, M. (2012). The empirical study of public transport passengers' behavioral intentions: the roles of service quality, perceived sacrifice, perceived value, and satisfaction (case study: paratransit passengers in jakarta, indonesia). *International Journal for Traffic and Transport Engineering, 2(1)*, 83-97.
47. Tang, Y., Stanworth, J., Chen, W., Huang, S., & Wu, H. (2015). Toward a measure of Chinese hypermarkt retail service quality. *Total Quality Management, 26 (3)*, 327-338.
48. Valdani, E. (2009). *Client & Service Management.* Milan: Egea.
49. Wong, A., Dean, A., & White, C. (1999). The impact of service quality on customer loyalty in the hospitality industry. *International Journal of Customer Relationship Management, 2(1)*, 81-89.
50. Wu, H. (2013). An empirical study of the effects of service quality, perceived value, corporate image and customer satisfaction on behavioral intentions in the Taiwan quick service restaurant industry. *Journal of Quality Assurance in Hospitality & Tourism, 14 (4)*, 364-390.
51. Wu, J., Lin, Y., & Hsu. (2011). An empirical analysis of synthesizing the effects of service quality, perceived value, corporate image and customer satisfaction on behavioral intentions in the transport industry: a case of Taiwan high-speed rail. *Innovative Marketing, 7 (3)*, 83-100.
52. Yu, W., & Ramanathan, R. (2012). Retail service quality, corporate image and behavioural intentions: the mediating effects of customer satisfaction. *The International Review of Retail, Distribution and Consumer Research, 22 (5)*, 485-505.
53. Yuen, E. F., & Chan, S. S. (2010). The Effect of Retail Service Quality and Product Quality on Customer. *Journal of Database Marketing & Customer Strategy Management, 17(3)*, 222-240.
54. Zaibaf, M. T., & Fakharian, M. (2012). Effect of perceived service quality on costumer satisfaction in hospitality industry: Gronroos' service quality model development. *Journal of Hospitality Marketing & Management, 22 (5)*, 409-504.
55. Zeithaml, V., Berry, L., & Parasurama, A. (1996). The behavioral consequences of service quality. *Journal of Marketing, 60(2)*, 31-46.
56. Zeithaml, V., Parasuraman, A., & Berry, L. (1990). *Delivering Quality Service.* New York: The Free Press.
57. Zhang, X., & Prybutok, V. (2005). A Consumer Perspective of E-Service Quality. *IEEE Transactions on Engineering Management, 52 (4)*, 461-477.

AGILE APPROACH IN ELECTRICAL ENGINEERING. RESEARCH IMPACT AND OUTCOMES

Cristina Mihaela Gheorghe
University POLITEHNICA of Bucharest, Romania
cristina.gheorghe@upb.ro

Anca Greculescu
University POLITEHNICA of Bucharest, Romania
anca.greculescu@upb.ro

Leonard Marius Melcescu
University POLITEHNICA of Bucharest, Romania
leonard.melcescu@upb.ro

ABSTRACT

Nowadays, the "project" is the basis for the organization of all human activities (Whitley, 2006; Davies, Hobday, 2005). The traditional approach of project management focuses on an ongoing and constant implementation plan. This sequential, deterministic approach proves efficient within a predictable less dynamic environment. Moreover, practitioners of project management point out possible digressions from the original plan due to disturbing events, unforeseen during the planning stage (Piperca, Floricel, 2012; Söderholm, 2008; Dvir, Lechler, 2004). Hence, the classic models of project management have become almost inefficient. A possible solution is the project management of software development, mainly AGILE approach. The prerequisite of AGILE is to elude the long-term fixed planning. As a result, the implementation plan proves flexible and unfolds throughout the project, including unforeseen events that are likely to occur throughout the project. The current paper illustrates the first research results and the aim is to benefit from the use of AGILE in project management within the field of Electrical Engineering. The ongoing research is exploratory, qualitative and the research instrument is the in-depth interview. The target group is made up of:

a) academic teaching staff with experience in research projects management in the field of Electrical Engineering;

b) employees of companies working in the Electrical and Electronic Engineering industries, who are versed in project management.

The first in-depth interviews were conducted between January-March 2017 and illustrated: (1) the level of AGILE knowledge in Electrical Engineering in Romania, (2) AGILE approach drawbacks, (3) possible ways of implementing AGILE in the field of Electrical Engineering, (4) unexpected events typical of Electrical Engineering.

Keywords: *AGILE Approach, Electrical Engineering, Project Management*

1. INTRODUCTION

It becomes noteworthy that modern society is becoming more and more dynamic. Budget rectifications (resulting from international financial crises and economic downturns or from a shift in strategic directions to improve financing), social, technological and climatic changes etc. have a higher aleatoric incidence and frequency. This contemporary reality makes classical project management methods become almost inefficient. Hence, the traditional approach of project management which reveals a clear purpose of the project, well defined tasks and fixed resource allocation, unchangeable throughout the project, fails to adjust to environmental changes likely to occur. As a result, a possible solution is the AGILE approach

to project management. Nevertheless, AGILE is rather a philosophy than a methodology, defining an array of methods: Scrum, Lean Development, Kankan (Rigby, Sutherland, Takeuchi, 2016a; Rigby, Sutherland, Takeuchi, 2016b; Sutherland, 2014). Likewise, in the purview of literature, AGILE is more often than not associated with software development (Dingsøyr, Nerur, Balijepally, Moe, 2012). The prerequisite of AGILE is to elude long-term fixed planning. Thus, the implementation plan is flexible and unfolds throughout the project, anticipating and including possible unforeseen events (Layton, 2012, pp. 11-26; Agile software development, 2016; Agile methodology, 2016). Considering both *(a)* the increased dynamics of our contemporary society, with consequences in Romania and *(b)* the significant amount of research that has been done studying the implementation of AGILE in IT, the added value of AGILE has also been pursued in the field of Electrical Engineering in Romania. The research mainly aims to outline the level of knowledge and implementation of AGILE in Electrical Engineering in Romania. Furthermore, the present study tackles the application of AGILE, as a major planning and management method for projects in this field of activity as well as the possible peculiarities of unexpected, disturbing events. The current research breaks down as follows: the second part deals with research methodology whereas the third outlines the research outcomes and future guidelines.

2. METHODOLOGY

The empirical research concerning the implementation of AGILE methodology in project management involves the need of a qualitative data collection method, mainly the in-depth interview. As a result, between January-March 2017, 16 in-depth, face-to-face, interviews were conducted. They lasted between 35 and 60 minutes, were recorded and a word-for-word transcript was elaborated afterwards. Two aspects were taken into consideration when choosing the target group: the respondents' expertise in project management and the great range of projects analyzed. In order to better study the management of all types of research projects (basic research, applied research and experimental development[1]) as well as non-research projects (e.g. design and manufactures cabinets for electrical distribution systems), the target group selection was based on three types of organizations: (1) technical higher education operating in the field of electrical engineering, (2) research & development institutes in the field of electrical engineering and (3) private (limited) companies that manufactures electrical and electronic equipment (see Table 1).

Table 1: Type of target group

Type of organization	No. respondents
One (1) technical higher education in the field of Electrical Engineering (specializations: electrical systems, electrical equipment, electrical measurements and drives, electromagnetic compatibility, electro power systems)	5
Two (2) research & development institutes in the field of Electrical Engineering (specializations: electrical systems electromagnetic compatibility; micro-nano-electrotechnology, power efficiency)	7
Three (3) private companies: ▪ industrial automation (equipment design, control panel design, application software development, activation etc.) ▪ applications of movement control (development, design and manufacturing of intelligent drives based on advanced DSP technologies, and control solutions for the application requirements); ▪ vehicle design and construction (automotive industry).	4

[1]Frascati Manual, edited by OECD, defines three types of research: basic research, applied research and experimental development (OECD, 2015, p. 45).

Hence, the target group was made of: a) academic teaching staff with expertise in research project management in the field of Electrical Engineering (in Romania, a full professor must have coordinated at least two research projects); b) researchers, employed by two national research institutes, versed in project management in the field of Electrical Engineering; c) employees of three companies operating in the field of manufacturing electrical and electronic equipment and automobiles. Top position staff and senior employees were selected since they are thought to provide an insightful vision of the projects carried out and of the relationship between the project teams, stakeholders and the third parties respectively. The top positions held by the sixteen respondents were: Managing Director, Industrialization Manager, Research Department Manager, Servomotors Department Manager, Head of Laboratory for Electromagnetic Compatibility, Deputy Head of Laboratory for Electromagnetic Compatibility, Process Control Engineer – Automation Team Leader, Senior Researcher, PhD Professor.

Each interview addressed four main topics regarding the prerequisites of AGILE. The main purpose was to garner information likely to help establish the extent of AGILE applicability to projects in the field of Electrical Engineering. The first topic of discussion (T1) questioned the AGILE's level of knowledge and application extent. Hence, each interviewee was asked how much they knew about AGILE methodology, their source of information, whether they had already applied this method or not etc. Provided the respondent never heard of this concept, he/she was given a briefing on AGILE principles. Moreover, they had to consider, based on their experience, whether AGILE could be applied in electrical engineering or not.

The second topic (T2) aimed to identify the main and most frequently used approach to project management. The objective was to analyze the project flexibility in the respective field of activity. A third topic (T3) tackled the aspects of communication and collaboration with stakeholders, throughout the implementation of the projects managed by the respondent. Finally, the fourth topic (T4) dealt with the bureaucracy of project management that the respondent had to face.

3. RESULTS. RESEARCH IMPACT AND OUTCOMES

The qualitative approach of the current study has led to a great amount of data otherwise unidentified by a quantitative one. This approach helped analyze, based on the project managers' experiences, the applicability of AGILE approach to the projects conducted in the field of Electrical Engineering. The first research results emphasized some benefits of the AGILE approach in Electrical Engineering and possible future guidelines: (1) AGILE level of knowledge in Electrical Engineering in Romania, (2) AGILE implementation drawbacks, (3) possible applications of AGILE approach in the field of Electrical Engineering, (4) unexpected disturbing events in Electrical Engineering in Romania.

3.1. AGILE level of knowledge in Electrical Engineering in Romania

The interviews revealed that AGILE methodology is almost unheard of by the project managers in this particular field of activity in Romania. Of the 16 respondents, only six heard of this concept, they never applied it though (see Table 2). With regard to the source of information, it was either due to contact (1) with people from abroad or (2) with people working in the field of IT (see Table 2).

Table following on the next page

Table2: Sources of information

	Respondents	Answers
1.	R1 (PhD Professor, Electrical Engineering Domain)	**Q:** *"Have you heard of AGILE methodology?* **A:** Yes, mostly for Horizont projects, research. **Q:** *Where was the first time you heard of AGILE? When, how and in what circumstances?* **A:** When working on project proposals and after that, during project management meetings. The first meetings on project management. **Q:** *From a partner or....* **A:** Yes, Horizont projects with partners, project managers. I wasn't a project coordinator so... I heard from the project coordinators. **Q:** *The first partners who made the proposal, where were they from?* **A:** Partners from Germany -Frankhofer, Italy – The Institute of Research. We work with partners from Germany, Denmark, Italy, not France, we didn't have the chance, ... this is our area of partnerships, Switzerland... Let's say it seemed to me they are far into the application and the Germans started long ago."
2.	R3 (Managing Director)	**Q:***"Do you know AGILE methodology?* **A:** Just heard of, never used it. **Q:** *How did you hear of it?* **A:** I thought it might be the methodology behind project management. **Q:** *How long ago did you hear of AGILE?* **A:** Aa, when I heard of, ten years ago or so...."
3.	R4 (Automation Team Leader, Industrial Automation Domain)	**Q:***"Have you heard of AGILE methodology?* **A:** Yes, I have. **Q:** *How did you hear of it?* **A:** Well, I have friends working for companies that develop software and they told me, from Scrum meetings and other similar stuff. Come on..., all of a sudden, the client changed half of his working ideas, let's go and see how we can replan, assign short-term tasks, longer term tasks, checkpoints and this kind of stuff."
4.	R6 (PhD Professor, Electrical Engineering Domain)	**Q:***"Have you heard of AGILE methodology?* **A:** Heard of, but I don't know much ... **Q:** *How did you hear of it?* **A:** I think I heard from somewhere, in the academic context, could be Université de Poitiers, Angoulême, ... at the library, it was a discussion with the students in short-term studies who did some internship in industry."
5.	R12 (PhD Professor, Electrical Engineering Domain)	**Q:***"Have you heard of AGILE methodology?* **A:** The method itself, yes, I've heard of. I have colleagues who teach at FILS[2], and there are many courses on Project Management. I've heard of it once or twice, the acronym seemed interesting. I don't know much."
6.	R16 (R&D Center Manager, Automotive Industry)	**Q:** *"Have you heard of AGILE methodology?* **A:** Of course I have, but I don't know. **Q:** *How did you hear of it?* **A:** It was about the development of our products. There's some interest from our executive to implement these methodologies."

[2]FILS = The Faculty of Engineering in Foreign Languages is a school of engineers where teaching is conducted in three international languages: English, French and German

It is noted that respondents who have heard of AGILE:

- take part in a team working on an international project (with partners from Italy and Germany);
- have done at least one training session abroad;
- interact with people who teach project management at faculties with studies conducted in foreign languages;
- are members of multinational organizations (e.g. automotive industry) willing to implement such a method for the management of projects;
- interact with people who work in the field of software development.

3.2. Drawbacks to the use of AGILE in Electrical Engineering

During the interviews, the participants were asked whether, based on their experience, AGILE approach could be implemented in the field of electrical engineering. Their answers, mainly regarding the gradual definition of the aim of the project, revealed five types of pitfalls when applying AGILE principles to project management in the field of electrical engineering.

Technical drawbacks. The technical drawbacks refer to particular electrical and electronic equipment, which is not modular, its components do not function separately, independently one from the other, so that this could be an added value. This is clarified by respondent R3 (Managing Director): *"You can't do half run or drive a motor for a very short time, it either runs or not.*", and by R4 (Automation Team Leader): *"It does not quite match, for the electrical project means electrical time span, if it's not tested, it's as if it didn't exist at all. So, you must produce something out of the box, you put it there and you're sure it works*." Hence, the flexible construction of the project is not possible, nor the teaching of modules at fixed periods of time, according to the literature.

Legal drawbacks. The field of Electrical Engineering is highly standardized, the electrical and electronic equipment is subject to strict safety and efficiency requirements. Consequently, on one hand, the degree of project flexibility is limited by the requirements and, on the other hand, by authorization and approval of implementing any change. The requirement "Copy Exactly!" (Copy Exactly requirements) is an important legal norm for electrical and electronic equipment. This aspect was underlined by respondents R2 (Industrialization Manager) and R3 (Managing Director) who are in charge of movement control applications (development, planning and manufacturing of intelligent drives). This norm stipulates that any change must be notified to the beneficiary for approval, nine months before the implementation procedure. More examples that highlight the legal drawbacks are provided by respondents R4 (Automation Team Leader): standards IEC 61511 and IEC 61508 respectively that regulate the safety of industrial processes.

Financial drawbacks. The complexity of electrical and electronic equipment leads to an "exhaustive" definition of AGILE that entails subsequent adaptation and extension of the project result (R16, R&D Center Manager). This kind of project definition and management includes back-up solutions, spare components and all this represents additional costs. The usefulness of these additional costs is not approved of or understood by the beneficiary, as shown by respondent R4 (Automation Team Leader):"*Agile, Agile, but one day for money*".

Informational (human) drawbacks. A flexible, exhaustive definition of AGILE, along with the permanent collaboration throughout the project between the management team and the stakeholders, requires different kind of data.

The respondents mentioned situations in which the lack of data was one of the pitfalls for the definition and implementation of the project. This lack of information means:

- reluctance of the project team to understand the use of the electrotechnical product and the corresponding characteristics the end product must present (R10, PhD Professor);
- beneficiary's lack of technical specialized knowledge (or his representatives'), as shown by respondents R4 (Automation Team Leader) and R5 (Research Department Manager).

In addition to the drawbacks afore listed, *inertia* suggests that individuals are used to a certain way of carrying out the tasks, as mentioned by respondent R16 (R&D Center Manager).

3.3. Application of AGILE Approach in Electrical Engineering

Two starting points and directions laid the basis for the identification of possibilities to apply AGILE to project management in electrical engineering: *types of projects* and *types of products*.

(A) The first starting point, a subjective one, was provided by the respondents' opinions. They were asked if and how AGILE could be applied to project management. They opinionated that such a approach could be implemented in project management regarding basic research, as illustrated in Table 3.

Table3: AGILE application to basic research

	Respondents	Answers
1.	R1 (PhD Professor, Electrical Engineering Domain)	**Q:** *"Based on your experience, do you think AGILE is applicable to electrical engineering?* **A:** Based on the other types of projects, it would be ideal to digress from the objective, it depends on what may happen throughout the project and on the technological evolution. Unfortunately, though, provided most of the people, associations and especially project managers are used to a relatively rigid style, anti-AGILE, they won't adapt. (...) the research activity, by definition, must not have a fixed objective, perfectly defined. Yet, technological development must. But scientific research, by definition, must not have an objective. Because, if you know in advance what you are supposed to achieve, you fail...that is, the likelihood to intentionally affect the research process, most of the time, unintentionally, is very high."
2.	R2 (Industrialization Manager)	**Q:** *"Do you think such a methodology could be used or to what purpose?* **A:** Well, there is a certain way to implement this concept even in the projects conducted by our own company and I'll tell you how. The moment we start thinking about a new class of products, we try to leave the door open to alternatives. And instead of saying *"we've got a solution"*, in due time, we try to elaborate the so-called catalogue of solutions."
3.	R5 (Research Department Manager)	**Q:** *"Do you think AGILE is applicable to electrical engineering?* **A:** If it's about a project on something, let's say, that is not funded, to see our expertise and train for something else, let's say we assign some research tasks here, in the organization, to see who and if we can do them, and then, we place them on the market."

This source of data helps elaborate the first direction for the application of AGILE approach in Electrical Engineering, mainly its application to certain *types of projects*.
(B) The second starting point, a more objective one, represents the projects managed by the respondents in time and set as an example. As shown in the methodology, the interviews aimed to identify the most frequent method used to manage projects as defined by the communication/collaboration with the beneficiary (product owner). This analysis has led to a new direction in the use of AGILE in electrical engineering, mainly based on *types of products*. Hence, three product dimensions were identified, adapted or not to the AGILE approach, mainly to the gradual definition of the aim of the project: (1) extent of product digitalization, (2) product modularity; 3) ratio between the electrical and mechanical components of a product.
(1) The extent of digitalization refers to the importance of software in the well functioning of the end product. The first outcomes reveal that such a methodology is more appropriate to products with a higher degree of digitalization *("There are products that combine hardware and software, so there's electronics and programming. Indeed, sometimes, we can modify or add something to the software, the hardware is more sensitive, the design needs modified and it's more complicated, but we'll do it anyway*." (R3, Managing Director).
(2) Product modularity deals with the internal structure of the product, its main components with independent functionality. From this point of view, high modularity products allow the use of a flexible AGILE type of management. An example is given by R4 (Automation Team Leader): *"for instance, the distribution cabinets, we know that when you install the analogical inputs, you take the risk of connecting cables too fast, if it's about switching from a two wire to a four wire system. Because, in spite of the fact it's settled in the project to be a two wire system, it's likely to be four. Thus, you step down to 24 volts, you pass it through a fuse and feed the respective circuit. Like an AGILE. So that's what it really means. At that level, AGILE, to my mind, is what I've planned and foreseen. There's, for sure, some other stuff, more space in the distribution cabinet so that you can move from one side to another, leave space to the left and right...the existing equipment that I know is modular and can be a solution*."
(3) With regard to the ratio between the electrical and mechanical components of a product, the research outcomes show that the application of AGILE increases at the same time as the amount of electrical parts included in the product, as explained by R4 (Automation Team Leader):*"this stuff is easier to keep when it comes to electrical design or software than to mechanical. That is flexibility is much worse there than...here*."

3.4. Unexpected events in project management within the field of Electrical Engineering in Romania

AGILE approach aims to manage projects in an external and dynamic environment in order to deal with unexpected disturbing events likely to occur during the project (Rigby, Sutherland, Takeuchi, 2016a; Rigby, Sutherland, Takeuchi, 2016b; Layton, 2012, pp. 19-26). There is fruitful literature regarding unexpected events, and there are numerous studies, causes and classifications of such events (e.g. Coulon, Barki, Paré, 2013; Piperca, Floricel, 2012; Söderholm, 2008). Hence, the current research aims to identify the most frequent events likely to affect project management in Electrical Engineering in Romania.
The disturbing events mentioned by the 16 respondents seem to differ according to the funding source: (a) public funds and (b) private financing.

(a) Regarding publicly funded projects which are mainly basic research projects, the disturbing event is triggered by the substantial budget cut, initially approved, doubled by a long period of evaluation of the project, as clarified by R8 (Senior Researcher): *"In the past, like in the case of this project which is still unfolding, this year too, there were*

budget cuts and few objectives. They had the upper hand because, in the name of science, even though the funds plummeted by 50%, the objectives didn't change, that's because each researcher wants to see his/her idea put into practice and it's a pity to take on a new project. So, things have gone bad because, initially, there were four (4) absolutely new ideas to be patented. In the course of a year, by the time they announced the winning projects, there were only two (2) ideas left out of 4, since the world is not standing still."

(b) Regarding private funded projects, the most frequent disturbing event seems to be the delay of delivery, especially within the more specialized niche areas: *"we had suppliers who delivered, had to deliver in May and it was the end of September when they actually did it. (...) The result was we didn't sleep for days on end, we would sleep three or four hours a night to catch up with the lost time, as much as we could.*" (R4, Automation Team Leader).

4. CONCLUSION

In the aftermath of an increasingly unpredictable environment, full of unforeseen events, it seems that AGILE approach is the most appropriate solution. Hence, the present study addresses the results of a qualitative research that aims to analyze the likelihood of implementing such a methodology for project management in the field of electrical engineering. The first results show that this concept is almost unknown and not applied to Electrical Engineering in Romania. Likewise, the research highlights some technical, financial, legal and informational drawbacks that diminish the chances of applying AGILE to project management in this field of activity.

With regard to the application of AGILE in the field of Electrical Engineering in Romania (and far beyond), the research results outline the possible use of AGILE in basic research projects. Moreover, provided a wide and varied array of projects associated with electrical engineering, in order to manage other types of projects (applied research, experimental development or non-research projects), the use of this approach must be correlated with the peculiarities of the product dealt with in the project.

ACKNOWLEDGMENT: *This work was supported by University POLITEHNICA of Bucharest, through the "Excellence Research Grants" Program, UPB – GEX. Identifier: UPB–EXCELENȚĂ–2016, "AGILE approach in Electrical Engineering projects", Contracts number 77/26.09.2016.*

LITERATURE:

1. *Agile software development*. Retrieved 08.12.2016 from https://en.wikipedia.org/wiki/Agile_software_development.
2. *Agile methodology*. Retrieved 08.12.2016 from: http://agilemethodology.org/.
3. *Manifesto for Agile Software Development*. Retrieved 08.12.2016 from http://agilemanifesto.org/iso/en/manifesto.html.
4. Coulon, T, Barki, H, Paré, G. (2013). Conceptualizing Unexpected Events in IT Projects. *Thirty Fourth International Conference on Information Systems*. Milan 2013. Retrieved 20.02.2017 from: https://www.researchgate.net/profile/Guy_Pare/publication/259622918_Conceptualizing_unexpected_events_in_IT_projects/links/54c803e10cf238bb7d0c91c1.pdf.
5. Davies, A, Hobday, M. (2005). *The Business of Projects. Managing innovation in complex products and systems*. Cambridge: Cambridge University Press.

6. Dingsøyr, T, Nerur, S, Balijepally, V, Moe, N.B. (2012). A decade of agile methodologies: Towards explaining agile software development. *Journal of Systems and Software*. 85(6). pp. 1213 – 1221.
7. Dvir, D, Lechler, T. (2004). Plans are nothing, changing plans is everything: the impact of changes on project success. *Research Policy*. 33. pp. 1 – 15.
8. Layton, M. (2012). *Agile Project Management for Dummies*. Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
9. OECD (2015). *Frascati Manual 2015: Guidelines for Collecting and Reporting Data on Research and Experimental Development, the Measurement of Scientific, Technological and Innovation Activities*. OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264239012-en. Retrieved 25.04.2017 from http://www.uis.unesco.org/ScienceTechnology/Documents/oecd-frascati-manual.pdf.
10. Piperca, S., Floricel, S. (2012). A typology of unexpected events in complex projects. *International Journal of Managing Projects in Business*. 5(2). pp. 248 – 265.
11. Rigby, D.K, Sutherland, J, Takeuchi, H. (2016a). The Secret History of Agile Innovation. *Harvard Business Review*. The April 2016 Issue. Retrieved 10.04.2017 from: https://hbr.org/2016/04/the-secret-history-of-agile-innovation.
12. Rigby, D.K, Sutherland, J, Takeuchi, H. (2016b). Embracing Agile. *Harvard Business Review*. The May 2016 Issue. Retrieved 10.04.2017 from: https://hbr.org/2016/05/embracing-agile.
13. Söderholm, A. (2008). Project management of unexpected events. *International Journal of Project Management*. 26(1). pp. 80-86.
14. Sutherland, J. (2014). *Scrum. The art of doing twice the work in half the time*. Crown Publishing Group.
15. Whitley, R. (2006). Project-based firms: new organizational form or variations on a theme? *Industrial and Corporate Change*. 15. pp. 77 – 99.

THE INFLUENCE OF CASH CONVERSION CYCLE ON PROFITABILITY OF TRADE IN SERBIA

Dragana Vojteski Kljenak
Faculty of Business Economics and Entrepreneurship, Belgrade
vojteski@live.co.uk

Vladan Cogoljevic
Faculty of Business Economics and Entrepreneurship, Belgrade
vladan.cogoljevic@vspep.edu.rs

Dusan Cogoljevic
Faculty of Business Economics and Entrepreneurship, Belgrade
dusan.cogoljevic@vspep.edu.rs

ABSTRACT
Numerous empirical studies proved that the cash conversion cycle is a significant factor of profitability of companies. Regarding this we attempt to analyse the influence of cash conversion cycle on profitability of trading companies in Serbia. Conversance with the character of positive or negative cash conversion cycle influence is crucial for undertaking the appropriate measures in order to improve financial performance of trading companies in Serbia in the near future. It primarily relates to optimization of net current assets, operational cycle and cash conversion cycle.
Keywords: *net current assets, operational cycle, cash conversion cycle, profitability*

1. INTRODUCTION

Cash conversion cycle is necessary measure of financial performance of firms. In trading firms, it measures the time it takes a company to convert its investment in inventory before it is sold and cash collected from customers. To aim at efficient financial management, cash conversional cycle is analysed among trade sectors, firms and categories of products. As well as in other firms, efficient cash management (optimal cash holding is one of the significant financial decisions that manager has to make) affects profitability of trade firms. In order to accomplish desirable profitability between cash conversional cycle and cash holding, regarding the determinants, there should be established appropriate relation for each trading firm (Das, 2015). The efficiency of managing net current assets reflects on operative cycle, cash conversion cycle, and, ultimately, on the profitability of trading companies, what is shown by many conducted empirical research (Moss, 1993; Topal, 2013; Shan, L.H, 2015; Li, 2014; Yazdanfar, 2014). The example of restaurant firms shows that working capital significantly affects their profitability. In the context of optimization there is inverted U-shape between working capital and profitability. Likewise, there is correlation between the cash holding and current assets, and profitability. Sum of cash holding significantly affects the efficiency of managing working capital. If working capital is positive it will have negative impact on profitability of restaurant firms, but negative will have positive impact on the profitability of restaurant firms (Mun, 2015). Generally speaking, the efficiency of managing net current assets is affected by type of inventories and customer's initiative to use credit (Mateut, 2015). Cash management, in the sense of accomplishing efficient optimisation, significantly affects liquidity (Warrad, 2015) and profitability of all companies (Das, 2015; Nizam, 2015). Adequate strategy and credit politics have immense impact on the growth of sales as a factor of net current assets and financial performance of all companies

(Yazdanfar, 2015), including trading. Concerning its significance, *the research issue* in this work is primarily to envisage the specifics of cash conversion cycle impact on profitability of trading companies. The *aim of the research* is to do thorough comparative research on factors of cash conversion cycle and its impact on the profitability of trading enterprises globally, in Europe and with special insight into Serbia. Extensive literature is written worldwide on the issue of impact of cash conversion cycle on profitability of firms, especially trading, while in Serbia there is no paper fully devoted to the research of this subject, which is only indirectly treated in the context of financial management of trade in Serbia (Lukić, 2012; Lukić, 2014). All accessible international theoretical, methodological and empirical knowledge in this work is used as fundamental basis for research of the influence of cash conversion cycle on the profitability of trading enterprises in Serbia. The primary *research hypothesis* in this work is that cash conversion cycle is significant factor of profitability of trading companies. It is tested on the example on numerous enterprises for the period 2010-2014. According to the issue, aim and the hypothesis, beside comparative analysis of selected countries, trading enterprises, types of stores and categories of products, *the research methodology* in this work also used regression model for measuring impact of the efficiency of managing net current assets and cash conversion cycle on performance of trade enterprises in Serbia respectively. In order to bring relevant conclusions we used other research methods, especially literature and case studies.

2. WORKING CAPITAL OF TRADE IN SERBIA

As in other countries, the role of trade is also important in creating performances of Serbian economy. It participated in total number of enterprises with 35.10%, in total number of employed with 19.46% and total revenue with 33.49 (calculation performed by the author based on the Business registers agency data). High share of trade in relevant indicators show that the structure of economy of Serbia has changed, and that it widely assumes characteristics of “tertiary business”. In this work, the number of covered trade enterprises from Serbia in statistical survey was as follows: 2010 – 35.474, 2011 – 33.849, 2012 – 32.933, 2013 – 33.905, and 2014 – 32.911, so we can consider the sample valid. Purchase and sale, managing of working capital belongs to important characteristics of trading companies’ performance in Serbia, as well in other countries. In order to manage working capital it is necessary to know all relevant aspects of its analysis: assets share, total revenues share, current liquidity, working capital turnover ratio, net current assets, operative cycle and cash conversion cycle. Table 1 illustrates share of working capital, current liabilities and capital in assets of trade in Serbia for the period 2010-2014.

Table following on the next page

Table 1. Share of working capital, current liabilities and capital in assets of trade in Serbia, 2010-2014

	Number of enterprises	Working capital, (%)	Inventory, (%)	Assets (%)	Current liabilities, (%)	Capital, (%)
2010	35474	57,78	19,18	37,69	57,54	28,65
2011	33849	57,16	19,61	36,39	56,75	30,94
2012	32933	56,37	19,66	35,64	55,39	29,99
2013	33905	63,00	22,26	23,84	63,33	34,53
2014	32911	63,32	22,43	23,87	62,16	35,28
Descriptive Statistics						
Minimum	32911,00	56,37	19,18	23,84	55,39	28,65
Maximum	35474,00	63,32	22,43	37,69	63,33	35,28
Mean	33814,400	59,5260	20,6280	31,4860	59,0340	31,8780
Std.	0	3,35671	1,57961	7,00463	3,49839	2,89271
Deviation	1043,6325	5	5	5	5	5
Valid N	0					
(listwise)	5					

Note: Calculations performed by the author.
Descriptive statistics calculated by SPSS statistic program
Source: Business registers agency

The data indicate that the average share in the assets in trade of Serbia is: working capital 59.52%, inventory 20.62%, assets 31.48%, current liabilities 59.03% and capital 31.87%. Given the specific character of business, such share is similar in trading business of other countries.

Liquidity is significant measure of financial performance of all companies, including trading. It is established as relation between current assets and current liabilities. Table 2 shows the current liquidity of trading companies in Serbia for the period 2010-2014.

Table 2. Liquidity of trade in Serbia, 2010-2014

	Current liquidity
2010	1,00
2011	1,00
2012	1,01
2013	0,99
2014	1,01

Note: Calculation performed by the author
Source: Business registers agency

The liquidity of trade in Serbia is very unfavourable, and significantly below the “gold banking rule” (current assets 2 : current liabilities 1), “industry standard” of comparable countries, especially European Union and the region.

In analysing turnover ratio we envisage the efficiency of managing assets, i.e. working capital in all economy sectors, including trading. Considering this, Table 3 represents working capital turnover in trade of Serbia for the period 2010-2014.

Table 3. Efficiency of managing working capital in trade of Serbia, 2010-2014

	Working capital turnover ratio	Inventory turnover ratio	Assets turnover ratio	Current liabilities turnover ratio
2010	2,17	6,55	3,33	2,18
2011	2,31	6,73	3,62	2,32
2012	2,34	6,70	3,70	2,38
2013	1,19	6,20	5,80	2,18
2014	2,19	6,18	5,81	2,23
Descriptive Statistics				
Minimum	1,19	6,18	3,33	2,18
Maximum	2,34	6,73	5,81	2,38
Mean	2,0400	6,4720	4,4520	2,2580
Std. Deviation	,48083	,26640	1,24277	,08899
Valid N (listwise)	5	5	5	5
	Working capital turnover in days	Inventory turnover in days	Assets turnover in days	Current liabilities turnover in days
2010	168	55	109	167
2011	157	54	100	157
2012	155	54	98	153
2013	166	58	62	167
2014	166	59	62	163
Descriptive Statistics				
Minimum	155,00	54,00	62,00	153,00
Maximum	168,00	59,00	109,00	167,00
Mean	162,4000	56,0000	86,2000	161,4000
Std. Deviation	5,94138	2,34521	22,47665	6,22896
Valid N (listwise)	5	5	5	5

Note: Calculations performed by the author.
Descriptive statistics calculated by SPSS statistic program
Source: Business registers agency

In trade of Serbia average turnover ratios of total and specific types of working capital are: working capital 2.04, inventory 6.47, assets 4.45, current liabilities 2.25. Average duration of its turnover expressed in days: working capital 162.40, inventory 56.00, assets 86.20, current liabilities 161.40. According to these data, the performance of managing working capital in trade of Serbia are bad in comparison to global trade, European trade and "industry standards". There is an obvious trend of decreasing period of accounts receivable collection in trade of Serbia. Nevertheless, it is shorter than time used for payment of current liabilities, above all - to vendors. In other words, trade in Serbia finances its business activity mostly from current assets sources.

Working capital is major indicator of financial performance of all companies, especially trade given the character of their business – purchase and sale of goods. Table 4 shows the dynamics of working capital of trade in Serbia for the period 2010-2014.

Table 4. Working capital of trade in Serbia, 2010-2014

	Working capital (million dinar)	Share of working capital in total revenue, (%)	Share of working capital in total assets, (%)	Working capital turnover ratio	Working capital turnover in days
2010	4.557	0,19	0,24	523	0,69
2011	9.447	0,31	0,41	315	1,15
2012	23.181	0,74	0,97	135	2,70
2013	-6.982	-0,23	-0,32	-426	-0,85
2014	25.423	0,83	1,15	119	3,06
Descriptive Statistics					
Minimum	-6.982,00	-,23	-.32	-426,00	-,85
Maximum	25.423,00	,83	1,15	523,00	3,06
Mean	11.125,2000	,3680	,4900	133,2000	1,3500
Std. Deviation	13449,88566	,43142	,58970	352,81185	1,58605
Valid N (listwise)	5	5	5	5	5

Note: Calculations performed by the author.
Descriptive statistics calculated by SPSS statistic program
Source: Business registers agency

As the data in the Table 8 indicate following average performance values are characteristic for working capital of trade in Serbia: working capital 11.125 million dinars, share of working capital in total revenue 0.37%, share of working capital in total assets 0.49%, working capital turnover ratio 133.20, working capital turnover in days 1.35. Therefore, the share of long-term fund sources in financing of working capital is at very low level in trade of Serbia. In 2013 working capital was fully financed from short-term sources, what is an indication of unsatisfied liquidity and solvency of trade in Serbia. Presented characteristics of working capital in the observed time period reflected on operative cycle and cash conversion cycle and profitability of trade in Serbia.

Table 5 shows profitability of trade enterprises in Serbia for the period 2010-2014.

Table following on the next page

Table 5. Profitability of trade Serbia, 2010-2014

	Return on revenue (net income / total revenue)	Return on assets (net income / assets)	Return on equity (net income/ equity)	Assets turnover ratio (total revenue / assets)	Financial leverage (assets / equity)	Firm size (Log 10)	Annual sales growth
2010	3,05	3,84	13,42	1,25	3,49	6,42	0,08
2011	3,20	4,24	13,70	1,32	3,22	6,45	0,08
2012	2,99	3,95	13,17	1,31	3,33	6,49	0,09
2013	2,97	4,12	11,93	1,38	2,89	6,48	-0,04
2014	2,87	3,98	11,30	1,38	2,83	6,48	0.01
Descriptive Statistics							
Minimum	2,87	3,84	11,30	1,25	2,83	6,42	-,04
Maximum	3,20	4,24	13,70	1,38	3,49	6,49	1,00
Mean	3,0160	4,0260	12,7040	1,3280	3,1520	6,4640	,2420
Std. Deviation	,12157	,15582	1,03587	,05450	,28411	,02881	,4271 1
Valid N (listwise)	5	5	5	5	5	5	5

Note: Calculations performed by the author.Descriptive statistics calculated by SPSS statistic program. Source: Business registers agency

Average values of some indicators of profitability of trade in Serbia in the observed period were: return on revenue 3.01%, return on assets 4.02%, return on equity 12.70%. Profitability of trade in Serbia is on the lower level compared to "industry standard" and comparable countries, above all countries of the European Union and the region. These were unfavourably affected by low assets turnover ratio (average relation of total revenue and assets is 1.32) and financial leverage (high indebtedness, assets and revenue relation is 3.15%), firm size (average Log 10 – 6.4640) and annual growth of sales (0.2420 on average).

3. CASH KONVERSION CYCLE OF TRADE IN SERBIA

Cash conversion cycle is very significant indicator of financial performance (i. e. factor of profitability) of companies. Regarding this, Table 6 presents operative cycle and cash conversion cycle of trading enterprises for the period 2010-2014.

Table 6. Operative cycle and cash conversion cycle of trade in Serbia, 2010-2014

	Operative cycle	Cash conversion cycle
2010	164	-3
2011	154	-3
2012	152	-1
2013	120	-47
2014	121	-42
Descriptive Statistics		
Minimum	120,00	-47,00
Maximum	164,00	-1,00
Mean	142,2000	-19,200
Std. Deviation	20,32732	23,17758
Valid N (listwise)	5	5

Note: Calculations performed by the author. Descriptive statistics calculated by SPSS statistic program. Source: Business registers agency

According to the analysis of the operative cycle, financial performance of trade in Serbia is very unfavourable – 142.20 days on average and prolonged – compared to global and trade of the EU. Beside, cash conversion cycle is negative, so more money is spent than earned. More money is spent than earned in sale of goods, for 19 days on average. It is negatively reflected on profitability of trade in Serbia. The data in Table 7 show that cash conversion cycle with minus sign has a weak impact on return on assets in trade of Serbia.

Table 7. Correlation analysis of impact of selected factors on profitability of trade in Serbia

		Return on revenue	Return on assets	Return on equity	Assets turnover	Financial leverage	Operative cycle	Cash conversion cycle
Return on revenue	Pearson Correlation	1	,494	,866	-,515	,568	,685	,680
	Sig. (2-tailed)		,398	,058	,375	,318	,202	,206
	N	5	5	5	5	5	5	5
Return on assets	Pearson Correlation	,494	1	,056	,490	-,405	-,267	-,173
	Sig. (2-tailed)	,398		,928	,402	,499	,664	,781
	N	5	5	5	5	5	5	5
Return on equity	Pearson Correlation	,866	,056	1	-,821	,890*	,936*	,934*
	Sig. (2-tailed)	,058	,928		,088	,043	,019	,020
	N	5	5	5	5	5	5	5
Assets turnover	Pearson Correlation	-,515	,490	-,821	1	-,977**	-,954*	-,861
	Sig. (2-tailed)	,375	,402	,088		,004	,012	,061
	N	5	5	5	5	5	5	5
Financial leverage	Pearson Correlation	,568	-,405	,890*	-,977**	1	,976**	,928*
	Sig. (2-tailed)	,318	,499	,043	,004		,004	,023
	N	5	5	5	5	5	5	5
Operative cycle	Pearson Correlation	,685	-,267	,936*	-,954*	,976**	1	,967**
	Sig. (2-tailed)	,202	,664	,019	,012	,004		,007
	N	5	5	5	5	5	5	5
Cash conversion cycle	Pearson Correlation	,680	-,173	,934*	-,861	,928*	,967**	1
	Sig. (2-tailed)	,206	,781	,020	,061	,023	,007	
	N	5	5	5	5	5	5	5

**. Correlation is significant at the 0.05 level (2-tailed).*
***. Correlation is significant at the 0.01 level (2-tailed).*

Note: Calculations performed by the author.
Descriptive statistics calculated by SPSS statistic program

In order to thoroughly analyse the treated issues in this work, we envisage the impact of cash conversion cycle on the profitability of trade in Serbia, with the help of regression model.

Regression model is as follows:

ROAi,t = a + b1CCC i,t + b2SIZEi,t + b3LEVi,t + ei,t

where: a is constant, ROAi,t profitability (%), CCCi,t cash conversion cycle (in days), Sizei,t firm size in time t (natural logarithm sale, Log 10), LEVi,t financial leverage of firm, and ei,t accidental statistical error.

Table 8 represents the results of the given regression model in analysing the impact of cash conversion cycle on profitability of trade in Serbia.

Table 8. Impact of cash conversion cycle on profitability of trade in Serbia - results of regression model (obs. 33814)

	Dependant variable: Return on assets			
Independent variable	Coefficients	Std. Error	t-statistic	Sig.
(Constant)	20,321	35,606	,571	,670
Cash conversion cycle (CCC)	,012	,013	,869	,545
Firm size (SIZE)	-1,892	5,132	-,369	7,775
Financial leverage (LEV)	-1,219	1,227	-,994	,502
(Weighted statistics)				
(R square)	,525			
(Adjusted R square)	-,902			
(SE of regression)	,21488			
(F-statistics)	,368			
(Sig. F)	,802			
(Durbin-Watson)	2,647			

Note: Calculations performed by the author.
Descriptive statistics calculated by SPSS statistic program

Results of the regression model show that cash conversion cycle almost has no effect on profitability of trade in Serbia. In other words, the impact of cash conversion cycle is marginal, with minus sign on profitability of trade enterprises in Serbia. In order to improve its impact it is necessary to manage total working capital and its manifestations (inventory, assets, liabilities) more efficiently in the future.
So as to thoroughly research the issue of impact of cash conversion cycle on the performance of trade in Serbia we will present working capital, operative cycle and cash conversion cycle of five largest trading companies in 2014. Observed trading companies participated in 2014 in market share with 9.14% (calculations performed by the author based on the Business registers agency data).

4. CONCLUSION

Net current assets (working capital) belongs to significant instruments of managing finance in trading companies. In reflects on operative cycle, cash conversion cycle as a factor of profitability of trading companies.

Cash conversion cycle of trade in Serbia is negative – more money is spent than earned in trade. Such negative cash conversion cycle had unfavourably affected profitability of trade in Serbia.

So as to improve the efficiency of cash conversion cycle on profitability of trade in Serbia it is necessary to manage more efficiently the working capital and all its manifestations (inventory, assets, short-term liabilities). In that context, huge part of working capital should be financed from long-term sources of funds. All that, and other relevant measures will have positive effect on profitability of trading enterprises in Serbia.

LITERATURE:

1. Lukic, R. (2012). Sustainable Development of Retail in Serbia. *Review of International Comparative Management*, 13 (4), 574-586.
2. Lukic, R. (2014)The economic and financial status of trade entrepreneurs in Serbia. *Economic and Environmental Studies*, 14 (3), 239 -264.
3. Lukic, R., Vojteski-Kljenak, D. and Jovancevic D. (2014). Food waste management. *Management Research and Practice*, 6(4), 23-39.
4. Mateut, S., Mizen, P. and Ziane, Y. (2015). Inventory composition and trade credit. *International Review of Financial Analysis*, 42, 434-446.
5. Michalski, G. (2007). Portfolio Management Approach in Trade Credit Decision Making. *Romanian Journal of Economic Forecasting*, 8(3),42-53.
6. Moss, J.D. and Stine, B. (1993). Cash Conversion Cycle and Firm Size: A Study Of Retail Firms. *Managerial Finance*, 19(8), 25-34.
7. Mun, S.G. and Jang, S. (2015). Working capital, cash holding, and profitability of restaurant firms. *International Journal of Hospitality Management*, 48 (20), 1-11.
8. Nizam,N.Z. and Hoshino, Y.(2015).Corporate Characteristics of Retailing Companies among Malaysia, Japan and USA. *International Journal of Business and Management*, 10 (6), 40-52.
9. Shan, L.H. et al., (2015). Working Capital Management Effect on the Performance of Wholesale and Property Industry in Malaysia. *Journal of Economics and Behavioural Studies*, 7(5), 19-28.
10. Warrad, L.H. (2015). The Impact of Cash Conversion cycle on Services Firms' Liquidity: An Empirical Study Based on Jordanian Data. *International Journal of Business and Management*, 10(10),108-115.

MODELS OF INNOVATION PROCESSES - THEORY AND PRACTICE

Elzbieta Szymanska
Bialystok University of Technology
15-351 Białystok, ul. Wiejska 45 A, POLAND
e.szymanska@pb.edu.pl

ABSTRACT

The research problem discussed in the paper is the innovation process. The aim of the study is to identify the specifics of the models of innovation processes and to compare them with the practice on the example of the health tourism innovation processes. The article consists of two parts: theoretical and practical. The first part proposes the concept of the 9 models of innovation processes based on a literature review. The theory is confronted with the results of empirical research. The study was conducted in 2016 on a group of 461 respondents represented by services of health tourism (Sections I and Q of the Polish Classification of Activity). The following methods were used: Delphi method, a questionnaire, a standardized interview and the ranking method. The Delphi research were conducted in 2015 with 12 experts participation. The research confirmed the proposed concept and showed a relatively small role of the more complicated models, as model of open innovation, user driven innovation (UDI), diffuse innovation in the innovation processes at the enterprises surveyed. The paper is novel in character, since to comparison the theoretical models with the practice of health tourism of innovation processes. The paper fills this gap in both the theory and practice.

Keywords: *Delphi method, health tourism, open innovation*

1. INTRODUCTION

Innovation is considered to be a major factor in economic development and is the object of research at the regional, national and international levels. Joseph A. Schumpeter (1960) is considered to have been the “father” of innovation theory. His concept provided the basis for the interpretation applied by the OECD (www.oecd.org), according to which innovation involves the transformation of an idea into a saleable product or service, a new or improved production or distribution process, or a new method of social service. In accordance with the OECD (2005) nomenclature, innovation can be related to a product, process, organisation or marketing. The research problem discussed in the paper is the innovation process. The aim of the study is to identify the specifics of the models of innovation processes and to compare them with the practice on the example of the health tourism innovation processes. The article consists of two parts: theoretical and practical. The first part proposes the concept of the 9 models of innovation processes based on a literature review. The theory is confronted with the results of empirical research. The study was conducted in 2016 on a group of 461 respondents represented by services of health tourism. The choice was based on the following premises: growing demand for services that are becoming increasingly important for society, interdisciplinarity and underdeveloped areas. The research has an interdisciplinary character and covers two research areas; specifically, medicine and the tourism economy.

The following research hypotheses were verified:

H1 - the model recommended by the experts is open innovation

H2 - the most commonly used innovation model is a linear process pushed by knowledge.

The following methods were used: Delphi method, a questionnaire, a standardized interview and the ranking method. The Delphi research were conducted in 2015 with 12 experts participation.

The paper fills this gap in both the theory and practice.

2. CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW

The concept of "innovation" is primarily associated with such terms as "change", "improvement" or "reform" (Innowacje…, 2005, p. 65-66). The term "innovation" comes from Latin and means the introduction of something new, a novelty, a reform – based on *innovatio*, which means "renewal", or *innovare*, which means "to renew"(Kopaliński 1978, p. 433).

The main issues of interest for innovativeness include innovation policy (Balezentis, & Balkiene, 2014). Another area of the research on innovativeness is the innovative activity of enterprises, mainly production enterprises (Tuominen, Rajala, & Möller, 2004; Perunovic & Christiansen, 2005) with particular consideration given to technological progress and R&D expenditure as well as their roles in the innovation process (Urban 2013). In addition, the researchers point out the significant role of advanced computer techniques and networked connections (Stepaniuk, 2015). Contemporary economic studies, including primarily the Oslo Manuals [the 3rd edition of 2005 and the subsequent ones] indicate that innovation can be found not only in manufacturing enterprises but also in services. However, there have been few studies on innovation in services (OECD 2005, Gault 2010; Ejdys et al. 2015), especially in tourism (OECD 2006, Hjalager 2010, Szymańska 2015, Panfiluk 2016). An important contribution in the scope of innovative converged service and its adoption was made by Motohashi et. al. (2012). The importance of clusters in the innovation process of enterprises is discussed by Borkowska-Niszczota (2015) and in spatial terms - with regard to the concept of smart city (Hajduk, 2016). Some publications deal with a very detailed topic, an example is the study of innovations in the aestetic tourism studied by Panfiluk (2016).

The point of departure for developing the models is innovation theory and innovation models of processes, particularly their more recent, starting with coupling models and ending with *spreaded innovation* models. These issues were considered by economists, such as P. K. Ahmed (2000), P. McGowan (1996), S. J. Kline and N. Rosenberg (1986), G. Roehrich (2004), Chesbrough (2003), and Hobcraft (2011). Table 1 shows different approaches to the innovation models. Table 1 shows different approaches to the models of innovation processes.

Table following on the next page

Table 1: Models of innovation processes (H. Chesbrough, Open Innovation. The New Imperative for Creating and Profiting from Technology, Boston: Harvard Business School Press, 2003; P. Hobcraft, Winning a New Products – Creating Value Trough Innovation, New York: Cooper, 2011; E. Szymańska, Construction of the Model of Health Tourism Innovativeness, "Procedia social and behavioral sciences," vol. 213 (2015), pp. 1008-1014, 2015)

Models of innovation	**Characteristics of the model**
Science pushed (pushed by knowledge)	A linear model of the innovation process *pushed by science*
Pulled by the market	A linear model of the innovation process *pulled by the market*
Conjugated	Interaction models where the connections among the individual elements result from the couplings between science, market and enterprise
Integrated and networked systems	Integrated systems based on networked connections – flexible, based on the system of a response related to the consumer, continuous innovation
Open innovations	The concept is based on the conviction that companies may, and even should, seek ideas and ways of creating innovations, not only within their structures, but also their environment – among external partners (companies, organisations and customers)
User driven innovation (UDI)	Demand-based approach to innovation - based on the conviction that consumers (users) have an increasingly large influence on the available commercial offers, participating in the process of creating products and services which they purchase.
Diffuse innovation systems	Focus on open innovations inside and outside the organisation. Innovation is created (higher value is generated) by establishing an efficient knowledge flow system (inside and outside)

The models described in the table can be divided into two main groups: linear and nonlinear models. Linear are the first two models. It was Kline and Rosenberg who noted that the innovation process can be more compicated than simple cause-and-effect. The new Chesbrough concept (2003) has launched discussions on a new open innovation model. The concept of UDI and diffusion innovations proposed by Hobcraft (2011) was the consequence of his proposals.

3. RESEARCH METHODS AND THE SELECTION OF THE RESEARCH SAMPLE

The scarcity of studies related to the subject and its complexity suggested choice of the research method applied in exploratory research, i. e. rather qualitative than quantitative.
The research was carried out in several stages using different methods (see Fig. 1).

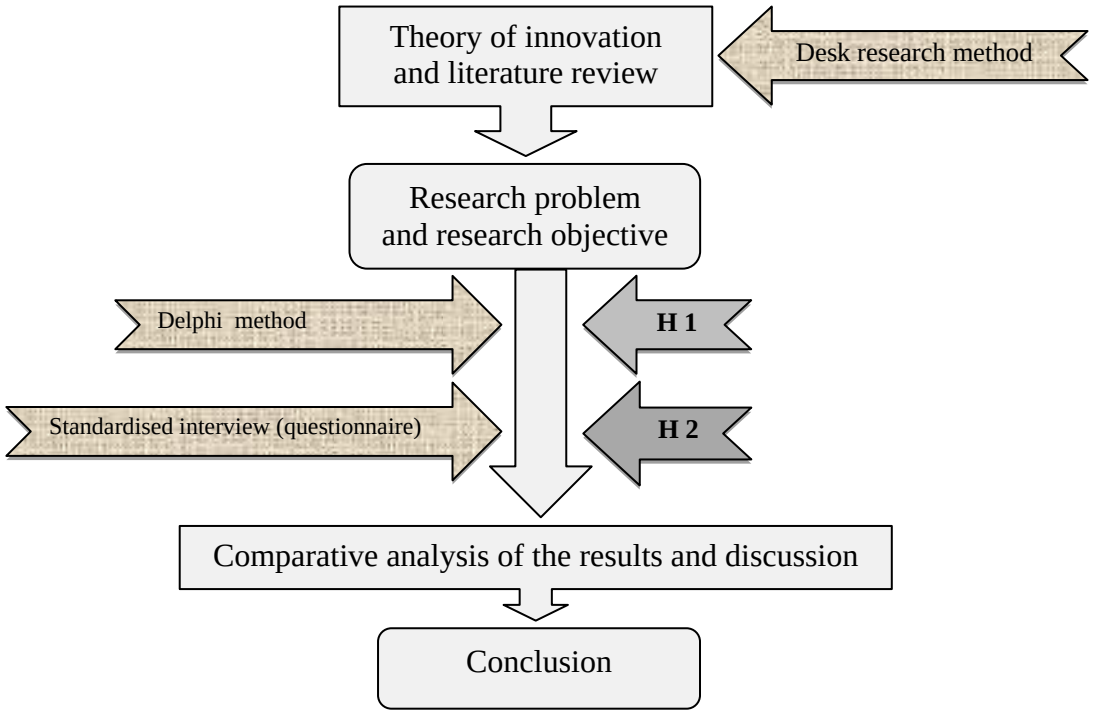


Figure 1: The research procedure applied (own elaboration)

The first stage of the research procedure was desk research of the literature according to theory of the innovation and the research in this field. It was done on the basis of the scientific literature on innovativeness, in particular, the OECD publications and in expert studies using the Delphi method. Following the recommendations of the *Oslo Manuals* (2005), the research covered a three-year period (from 2013 to 2015).

The research covered providers of health tourism services which had been identified by the expert method. The research was carried out in 2015. 12 experts who represented the field of economic sciences and had scientific achievements in the areas of innovations and tourism economics, including that of health tourism, were invited to participate in the research. The experts also included practitioners. Delphi survey is one of such methods and it is widely employed in both medicine (Hasson *et al.* 2000) and tourism research (Donohoe *et al.* 2009) areas. The actual Delphi survey was administered online (CAWI) and consisted of 2 rounds. After the first round the panellist were informed about its outcomes and could change or support their opinions. So that the panellist could deliver their own input to the subject every question was supplement with the space and instruction encouraging them to provide comments or ideas relevant to the particular issue.

On the basis of the experts' opinions, a list of providers of health tourism services was drawn up. The whole size of the examined population was determined on the basis of the local data bank (BDL) as consisting of 241,393 entities. The size of the representative sample was calculated using the calculator of the research sample. The following parameters were adopted for the calculation of the size of the examined sample: the confidence level of 0.95, the expected fraction size of 0.5 and the maximum error of 0.05. As a result of the calculations, the minimum sample size was determined as 384 entities.

The next stage was market research carried out on providers of health services. The research material was collected using a survey questionnaire as a tool. Three techniques were applied to collect data: CAWI, PAPI and a telephone interview. Ultimately, as a result of the research (with a simple random selection) carried out from November 2015 to 2016, questionnaires were collected from 461 entities.

4. RESULTS OF THE RESEARCH CONDUCTED

The innovativeness models proposed as the research theses were designed on the basis of the considerations reported in the literature which were described in the first chapter. As a result of these considerations, 9 different models of innovativeness systems were developed (table 1). For the respondents, thesis were proposed concerning the particular innovativeness processes. The Table shows the results of the research in the form of an average number of indications in both of the Delphi and quantitative research.

Table 2. Models of innovation processes and Delphi results (results of round I/results of round II) and questionnaire survey results

Systems	Results of two rounds of the Delphi poll	Results of the questionnaire survey
Science pushed	7/5=12	63
Pulled by the market	11/9=20	152
Conjugated	9/5=14	69
Integrated and networked systems	6/6=12	52
Information technology systems and information and communication technology systems	2/0=2	30
Self-learning systems	4/2=6	0
Open innovations	15/6=21	34
User driven innovation (UDI)	6/3=9	46
Diffuse (spread) innovation	3/0=3	13
No model		102

Source: own elaboration based on the research and E. Szymańska, Construction of the Model of Health Tourism Innovativeness, "Procedia Social and Behavioral Sciences", 213 (2015), pp 1008-1014. [18]

The results of the performed qualitative and quantitative research, it should be recognised that the results of the two types of research are very different. Table 2 shows the results of two types of research: qualitative and quantitative ones. The beginning of the results were presented by Szymańska (2015). In the experts' opinion, each of the forms of this tourism operates in a different innovation system to which different models correspond, but the open innovation model, described by Chesbrought (2003) is most suitable for the innovation processes in health tourism. They assigned together 21 indications to this model. This is a modern, progressive model which is conducive to innovation. However, the results of quantitative research are contradictory with the experts' opinions. Only few enterprises (34, i.e. 7% of the respondents) indicated the use of the open model. The largest number of respondents, representing 33% (152 entities) indicated a linear, market-pulled innovation process. Many entities (22%) declared that they did not use any innovation system or model. A much smaller group of respondents indicated the conjugated model (69 respondents, representing 15%) and the science-pushed model (63 respondents, i.e. 14%). It should be noted that the higher the generation of the model (the more interactive and open to the environment the model is), the fewer respondents' indications it gets. The *diffuse innovation* system took the last position.

A comparison of the two models suggested by the experts and the one indicated by the service providers, clearly shows differences between them. Above all, the open innovation process is more complex. This is a process which enables the enterprise to open to its

environment and cooperation and which facilitates its entry into a new market. In contrast, the diagram showing the linear process is very simple. Such models were developed at the beginning of the development path of innovation theory, i.e. in the mid-1950s. It seems, that, in light of this, it can be concluded that the applied innovation processes should be revised and that providers of health tourism services in Poland lack knowledge or perhaps openness to cooperation with other entities in the external environment.

5. LIMITATIONS AND DISCUSSION

In the course of the research certain limitations occurred. They were caused by the need to formulate the models of the innovation processes. Given that this research is *in statu nascendi*, action should be launched to assess other groups of respondents (firms) opinions on the processes innovations introduced.

Research has shown that most innovation processes do not go beyond the boundaries of the enterprise. The linear model predominates, with almost a quarter of respondents not using any model. Reismann (2010) writes about the high level of international cooperation in innovation. The results do not confirm his opinion. Although the survey did not ask respondents for cluster cooperation, as Hollenstein (2003) studied, however, the nature of the processes (mostly closed) shows a low degree of cooperation in the creation of innovation. The results of the present research confirm the earlier conclusions of Garcia-Altes (2005) that the combination of tourism and medicine, i.e. activities going beyond sectoral boundaries, are a favourable environment for creating innovations.

6. CONCLUSION

The research which was carried out made it possible to achieve the main goal and to verify the hypothesis. Thus, the first hypothesis (H1), providing the model recommended by the experts is open innovation was positively verified. In contrast, the second hypothesis (H2) was verified negatively, since the the most commonly used innovation model is a linear process pushed by market, not by knowledge.

The main conclusion which can be drawn is that the innovation processes applied at providers of health tourism services have a simple, linear character (33% *pulled by market* and 14% *pushed by market*), indicating an initial stage of the development of innovation processes. A positive phenomenon in the process of development of innovation in the health tourism is the presence of a large variety of systems.

In light of the fact that the experts' opinion indicates the open innovation as the most optimum one, it can be recognised that it would be well-advised for managers of the investigated entities to deepen their knowledge concerning the opportunities offered by openness in the course of innovation processes, while this research should be continued to determine which innovation systems (models) are applied by the most innovative enterprises, since it can be presumed that they apply more complex innovation process models. It turned out that the open innovation model was seldom applied on the market, since only 7% of respondents indicated that they used the open innovation process. It should be noted that the low level of use of the different models during the innovation process than the linear. The results of this research should be subjected to a deep discussion. It should be considered why enterprises providing services which are so important for society do not follow their customers' opinions in the innovation process. This is a challenge for the future which demonstrates the need for the relevant research to be deepened. This study is novel in character, both as regards the issues considered and the models elaborated, making a contribution to innovation theory and economy science.

LITERATURE:

1. Ahmed, P.K. (2000). Sixth generation innovation: Innovation management systems into future. *European Journal of Innovation Management*, no. 3.
2. Balezentis, A., & Balkiene, K. (2014). Innovation policy measurement: analysis of Lithuania`s case. *Economic Research – Ekonomska Istrazivanja*, 27, pp. 1-14. doi:10.1080/1331677X.2014.947103
3. Borkowska-Niszczota, M. (2015). Tourism Clusters in Eastern Poland – Analysis of Selected Aspects of the Oparation. *Procedia-Social and Behavioral Scciences*, nr 213, pp. 957-964.
4. Chesbrough, H. (2003). *Open Innovation. The New Imperative for Creating and Profiting from Technology*. Boston: Harvard Business School Press.
5. Donohoe, H. M. Needham R. D. (2009). Moving Best Practice Forward: Delphi Characteristics, Advantages, Potential Problems, and Solutions. *International Journal of Tourism Research* 11: pp. 415–437.
6. Ejdys, J. (2015). Ustinovičius L., Stankiewičienė J., Innovative application of contemporary management methods in a knowledge-based economy interdisciplinarity in science, *Journal of Business Economics and Management*, vol 16, no 1, pp. 261-274.
7. Garcia-Altes, A. (2005). The development of health tourism services. *Annals of Tourism Research*, 32 (1), 262-266. doi:10.1016/j.annals.2004.05.007.
8. Gault, F. (2010). *Innovation Strategies for a Global Economy*. UK Cheltenham: Edward Elgar.
9. Hajduk, S. (2016), Selected aspects of measuring performance of smart cities in spatial management. *Business and Management*. pp. 8-16.
10. Hasson, F., Keeney, S. (2011). Enhancing rigour in the Delphi technique research. *Technological Forecasting & Social Change* 78: 1695–1704. Available from Internet: doi:10.1016/j.techfore.2011.04.005
11. Hjalager, A-M. (2010). A review of innovation research in tourism. *Tourism Management* 31. pp. 1–12. doi:10.1016/j.tourman.2009.08.012
12. Hobcraft, P. (2011). *Winning a New Products – Creating Value Trough Innovation*, New York: Cooper.
13. *Innowacje i transfer technologii. Słownik pojęć (Innovation and Technology Transfer. A Dictionary of Terms – in Polish)*. (2005). PARP. Warsaw, pp. 65-66.
14. Kline, S. J., Rosenberg, N. (1986). *An Overview of Innovation*, [w:] *The Positive Sum Strategy: Harnessing Technology for Economic Growth*, R. Landau, N. Rosenberg (red.), National Academy Press, Washington.
15. Kopaliński, W. (1978). *Słownik wyrazów obcych i obcojęzycznych (A Dictionary of Foreign and Foreign-Language Terms – in Polish).* WP. Warsaw.
16. McGowan, P. (1996). *Innowacje i przedsiębiorczość wewnętrzna [Innovation and Internal Entrepreneurship]*, [in:] *Praktyka kierowania. Jak kierować sobą, innymi i firmą [Targeting Practice. How to manage yourself, others and your company]*. D. Steward (Ed.), PWE, Warszawa.
17. Motohashi, K., Lee, D-R. (2012). Yeong-Wha Sawng, Seung-Ho Kim, Innovative converged service and its adoption, use and diffusion: a holistic approach to diffusion of innovations, combining adoption-diffusion and use-diffusion paradigms, *Journal of Business Economics and Management*. vol 13, no 2, pp. 308-333.
18. OECD, Eurostat. (2005). *Oslo Manual: Guidelines for collecting and interpreting innovation data*. Paris: OECD.
19. OECD. (2006). *Innovation and Growth in Tourism*, Paris.
20. Panfiluk, E. (2016). Aesthetic medicine tourism – nature and scope of services. *Ekonomia i Zarządzanie*, 8, (1), 71-79. doi:10.1515/emj-2016-0008

21. Perunovic, Z., & Christiansen, T. B. (2005). Exploring Danish innovative manufacturing performance. *Technovation*, 26, 1051-1058. doi:10.1016/j.technovation.2004.02.013
22. Reismann, D. (2010). *Health tourism: Social welfare through international trade.* Cheltenham, UK: Edward Elgar.
23. Roehrich, G. (2004). Consumer innovativeness. Concepts and measurements. *Journal of Business Research*, vol. 57, pp. 671-677.
24. Schumpeter, J.A. (1960). *The Theory of Economic Development*, Galaxy Book, New York, 1932; Polish edition: *Teoria rozwoju gospodarczego*, PWN, Warsaw.
25. Stepaniuk, K. (2015).The Relation between Destination Image and Social Media user Engagement - theoretical Approach. *Proceedia: Social and Behavioral Sciences*, 213: 616-621, doi: 10.1016/j.sbspro.2015.11.459
26. Szymańska, E. (2015). Construction of the Model of Health Tourism Innovativeness, *Procedia - Social and Behavioral Sciences*, 213:1008-1014.
27. Tuominen, M., Rajala, A., & Möller, K. (2004). How does adaptability drive firm innovativeness. *Journal of Business Research*, 57, 495-506. doi:10.1016/S0148-2963(02)00316-8
28. Urban, W. (2013). Co-created service quality: Theoretical deliberations and qualitative investigation findings, *Contemporary Research on Organization Management and Administration Journal*, vol. 1, pp. 119-128.
29. www.oecd.org , [30.12.2016]

FINANCIAL EXPENDITURES OF TRADING ENTERPRISES IN SERBIA

Dragana Vojteski Kljenak
Faculty of Business Economics and Entrepreneurship, Serbia
vojteski@live.co.uk

Zorana Nikitovic
Faculty of Business Economics and Entrepreneurship, Belgrade
djurazo001@gmail.com

Dusan Cogoljevic
Faculty of Business Economics and Entrepreneurship, Belgrade
dusan.cogoljevic@vspep.edu.rs

ABSTRACT
Due to the economic crisis and the risk of doing business, the issue of the efficiency of managing financial expenditure in all enterprises, including trading is raised. It especially relates to the trading enterprises in transition countries, such as Serbia. The comparative research showed that financial expenditure of trading enterprises in transition countries are incomparably higher compared to the countries with developed market economy. The aim of the research in this work is to envisage the importance of the financial expenditures in modern trade companies, with special insight into Serbia. In contrast to the countries with developed market economy, significantly higher financial expenditures in trading companies in Serbia reflected badly on their performance. Such condition is caused by following factors: high interest rate, indebtedness, high business risk, total financial instability, inadequate strategies and business politics, etc. Regarding this, it is necessary to take all relevant measures so as to increase the competitiveness and the efficiency of managing financial expenditures in trading enterprises in Serbia.
Keywords: *interest, negative exchange rate difference, efficiency, cost of debt, Serbia*

1. INTRODUCTION

As it is known, the total expenditures are significant determinant of the performance of all enterprises, including trading. The structure of total expenditures of trading enterprises comprises of: business expenditure (acquisition value of goods and operating costs), financial and other expenditures. By the definition, financial expenditures are total costs which provide project financing or business arrangements. The costs of financing can include the interest payment, the financing of compensation to the indirect financial institutions, as well as compensation or wages of stuff which participate in financing process conduct. According to the International Accounting standard 23, borrowing cost are defined as "interest and other costs incurred by an entity in connection with the borrowing of funds" (8).

The *subject of the research* in this work is specific features of financial expenditures of trading enterprises, with special insight into Serbia. The financial expenditures of trade enterprises in Serbia are mostly interests and negative exchange rate difference.

The *aim* of this work is to thoroughly explore the specifics, importance and factors of the dynamics of size and structure of financial expenditures of trading enterprises, especially in Serbia. Based on the original empirical data for the period 2008-2013 we made detailed analysis of financial expenditures of trading enterprises in Serbia. Great number of trading

enterprises which are lawfully obliged to give annual financial reports to Business register of Serbia were analysed in each year, thus providing valid statistical sample.
As it is known, there is hardly any paper completely devoted to the specifics of the impact of financial expenditures on competition and performance of trading companies (wholesale and retail) (2). In *literature*, this problem is partially researched in the context of general research of specifics and importance of adequate financial strategies in trading companies (1, 3, 4, 5, 6, 7, 9, 10, 11, 12, 13, 14, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35). It is specially the case with the literature in Serbia (15, 16, 17, 18, 19, 20, 21, 22, 23, 24).
In other words, according to our knowledge, there is no complete work which is devoted to the research of the specifics of the impact of financial expenditures, as significant determinant of competition and performance of trading companies in Serbia. This gap should be filled with this work which, in its essence, timing and manner of the research, should give adequate theoretical, methodological and empirical basis for efficient managing of financial expenditures as a function of improving competition and total performance of trading companies in Serbia in the future.

2. THE IMPACT OF FINANCIAL EXPENDITURE ON THE PERFORMANCE OF TRADE IN SERBIA

As it is known the size of financial expenditures of trading enterprises is affected by interest rate and the amount of bank loans for property financing. *The trade participated intotal number of approved loans* in Serbia from 13,6% up to 17,3% (Table 1). This number is also high in certain types of property (investments in turnover and capital assets) financed from credit sources.

Table 1.The percentage structure of loans per economy sectors in Serbia, 2008-2015

	2008	2009	2010	2011	20012	2013	2014	Q1 2015
Agriculture loans from total loans (%)	3,3	3,1	3,0	2,8	3,0	2,7	3,5	3,4
Industrial loans from total loans (%)	18,4	17,9	19,3	17,2	17,9	18,4	19,2	18,8
Trade loans from total loans (%)	16,9	17,3	16,6	14,7	15,0	13,5	13,9	13,6
Construction loans form total loans (%)	5,8	5,3	6,9	6,2	5,8	4,6	4,2	4.1
Other loans to enterprises from total loans (%)	8,1	9,8	9,7	10,9	12,8	11,4	11,5	12,0

Source: National Bank of Serbia

So, for example, in 2012 the percentage of financial credits in financing investments of basic funds in Serbia amounted: total economy 19,86%, agriculture, forestry and fishing 25,08%, mining 3,02%, processing industry 18,12%, electrical, gas and steam supply 11,12%, water supply and waste water management 8,89%, construction 34,92%, wholesale, retail, vehicle repair - total 16,16%, wholesale, retail, vehicle repair 22,17%, wholesale except motor vehicle trade 14,01%, retail, except motor vehicle trade 17,66%, traffic, warehousing and communication 16,65%, accommodation and food 9,02%, information and communication 22,29%, financial and insurance business 33,44% (author's calculation based on Statistical Yearbook of the Republic of Serbia 2014, The statistical Office of the Republic of Serbia) (http://pod2.stat.gov.rs/ObjavljenePublikacije/God/SGS2014.pdf) (accessed 20/7/2015 10:AM). Based on these data (percentage ratio) it can be concluded that financial share of credits in financing investments of basic funds of trade in Serbia is significant.

It is also high in financing of turnover assets. Beside bank credits, there is significant percentage of suppliers in stocks financing. Collection period is long, much longer than the "industry standards" in countries with high financial discipline. The substantial share of total financial credits in financing of trade in Serbia reflected, beside very high interest rate and unfavourable exchange rate, on the size of financial expenditures as one of the determinants of competitiveness and overall performance.*The capital structure* is also significant determinant of financial expenditure. Table 2.shows the capital structure of trade in Serbia for the period 2008-2013.

Table 2.Capital structure of trade in Serbia, 2008-2013

	Number of enterprises	Assets/capital	Long-term liabilities/assets, (%)	Short-term liabilities/assets, (%)	Total liabilities / Assets, (%)	Total liabilities / Shareholders capital, (%)	Long-term liabilities / Shareholders capital, (%)	Long-term liabilities / Total capital, (%)
2008	37,077	2,637	13,88	48,27	61,65	162,59	35,29	13,44
2009	34,982	2,747	13,22	49,93	63,15	174,13	36,33	13,25
2010	35,474	3,490	13,30	57,55	70,86	247,33	46,43	13,36
2011	33,451	3,237	11,59	57,05	68,64	222,24	37,53	11,64
2012	33,393	3,333	13,48	55,81	62,29	230,97	44,96	13,58
2013	33,341	3,224	11,77	56,55	68,32	220,30	37,96	11,80

Note: Author's calculation
Source: Business registers agency

The structure of capital of trade in Serbia is unfavourable. In Serbia, the financial indebtedness is high and has reflected on interest rate as a determinant of trading enterprises performance. Table 3 shows financial revenues and expenditures of trade in Serbia for 2008-2013 period.

Table following on the next page

Table 3.Financial revenues and expenditures of trade in Serbia, 2008-2013

	Financial revenues		Financial expenditures			Net financial expenditures	
	Amount (thousand dinars)	Share of financial revenues in total revenues, (%)	Amount (thousand dinars)	Share of financial expenditures in total revenues, (%)	Share of financial expenditures in total expenditures, (%)	Amount (thousand dinars)	Share of net financial expenditures in total revenues, (%)
2008	57,370,872	2,13	111,033,904	4,44	4,49	53,663,321	2,14
2009	46,191,911	1,99	102,912,314	4,35	4,38	56,720,403	2,40
2010	54,509,059	2,08	117,641,904	4,49	4,49	63,132,845	2,41
2011	59,770,004	2,11	92,750,578	3,28	3,32	32,980,074	1,16
2012	60,049,082	1,92	116,042,075	3,71	3,72	55,992,993	1,79
2013	37,450,796	1,26	65,668,167	2,20	2,23	28,217,371	0,94

Note: Author's calculation
Source: Business registers agency

Based on provided data we can make a conclusion: 1) percentage share of financial revenues in total revenues ranged from 1,26 – 2,13% in the observed period; 2) percentage share of financial expenditures in total revenues ranged between 2,20 – 4,49%; 3) percentage share of financial expenditures in total expenditures ranged from 2,23 – 4,44% in observed time period; and 4) percentage share of net financial expenditures in total revenues ranged from 0,94 – 2,41%. Therefore, net financial expenditures of trade in Serbia were the highest in 2010.

The share of financial revenues in total trade revenues in 2013 was 1,26% and lower than in total economy in the Republic of Serbia (which amounted – 2,46%). The share of financial expenditures in total expenditures of trade in Serbia in 2013 (2,23%) was also lower compared to total economy of the Republic of Serbia (2013 – 3,83%). The share of net financial expenditures in total revenues of trade in 2013 (0,94%) was lower than in total economy of the Republic of Serbia (2013 – 1,34%). (Author's calculation for total economy of the Republic of Serbia based on the data of the Business registers agency.)

Compared to net financial expenditures in trade of countries with developed market economy, they are incomparably higher in Serbia. It is due to high bank interest rate and negative fluctuation of exchange rate concerning the fact that the credits given to the economy are indexed in foreign currency (mostly in Euros). High risk of business in Serbia is also significant determinant of the size of financial expenditures (interest expenditures) of all enterprises, including trading.

In the context of the analysis of influence of financial expenditures on competition and performance of trade in Serbia it is necessary to envisage the *interest coverage ratio*. In this work interest coverage ratio is calculated as follows: interest coverage ratio =(interest + net income) / interest. Table 4 show the interest coverage ratio of trade in Serbia for the period 2008-2013.

Table 4. Interest coverage ratio of trade in Serbia, 2008-2013

	Interest coverage ratio
2008	1,76
2009	1,72
2010	1,68
2011	1,98
2012	1,80
2013	2,36

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Interest coverage ratio	6	1,68	2,36	1,8833	,25563
Valid N (listwise)	6				

Note: Author's calculation of interest coverage ratio and descriptive statistics with the application of SPSS
Source: Business registers agency

In Serbian trade in all observed years, except 2013, one dinar of interest was covered with less than one dinar of net income, 0,88 dinars on average. Dynamically observed, in analysed period the interest coverage with net income had cyclic movement, in which significant increase was recorded in 2013.
In order to thoroughly envisage the interest coverage ratio in Serbian trade it is necessary to analyse the relationship between the capital and interest (capital/interest) which, for the period 2008-2013, was as follows: 2008 – 7,17, 2009 – 7,80, 2010 – 5,06, 2011 – 7,16, 2012 – 6,08, and 2013 – 11,32 (author's calculation based on the data of Business registers agency). In all observed years one dinar of interest was (averagely) covered with seven dinars of capital, except 2013 when coverage exceeded 11 dinars. In the context of the interest coverage ratio analysis it is necessary to envisage the relationship between the ratio and net cash flow from operating activities (interest/net cash flow from operating activities). This indicator shows how much one generated dinar of net cash flow from operating activities covers interest.
The cost of debt (showed as percentage relationship between financial expenditure and total liabilities: financial expenditure/total liabilities) is significant determinant of performance of all enterprises, including trading. Table 5 show the cost of debt in Serbian trade for the period 2008-2013.

Table following on the next page

Table 5. The cost of debt in Serbian trade, 2008-2013

	The cost of debt, (%)
2008	8,51
2009	7,33
2010	7,92
2011	6,23
2012	7,04
2013	3,96

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
The cost of debt (%)	6	3,96	8,51	6,8317	1,60633
Valid N (listwise)	6				

Note: Author's calculation of the cost of debt and descriptive statistics with the application of SPSS
Source: Business registers Agency

The cost of debt of trade in Serbia ranged from 3,96% (2013) up to 8,51% (2008) in the given period. On average, they were 6,83%. Dynamically observed, they had cyclic movement, with significant decrease in 2013. All in all, the cost of debt of trade in Serbia was much higher (almost double) compared to the trade of developed market economies.
The cost of debt affects profitability of all enterprises. Considering the goals, the profitability in trading enterprises is expressed differently. In this work, in order to measure the profitability of trading enterprises in Serbia we will use the indicator – profit per employee, because there is no need to make any accounting adjustment considering the unequal application of accounting and other regulations. Besides, we can envisage the influence of intangible assets (intellectual capital, knowledge, talent and skills of employees) on the performance of trading companies. Profit per employee in Serbian trade for the period 2008-2013 is showed in Table 6.

Table 6. Profit per employee of trade in Serbia, 2008-2013

	Number of employees	Net profit (000 dinars)	Net profit per employee (000 dinars)*
2008	215,540	84,995,251	394
2009	207,325	75,376,369	363
2010	197,677	79,198,098	400
2011	200,801	91,822,735	457
2012	193,954	93,687,650	483
2013	191,653	89,440,797	466

Note: Author's calculation
Source: Business register agency

In Serbian trade, profit per employee ranged from 363,000 (2009) up to 483,000 (2012) dinars in the observed period. It is significantly lower (expressed in Euros) than in the European Union trade (see Eurostat).In further analysis of the treated problem we will

research the impact of the cost of debt on profit per employee in trade in Serbia for the period 2008-2013 by using the statistical analysis (descriptive statistics and correlation analysis). Regarding the number of huge number of trading enterprises for each year, the statistical sample is valid.Table 7.shows the descriptive statistics of the cost of debt and net profit per employee in trading enterprises of Serbia, 2008-2013.

Table 7. Descriptive statistics of the cost of debt and net profit per employee in trading enterprises of Serbia, 2008-2013

	N	Minimum	Maximum	Mean	Std. Deviation
The cost of debt (%)	6	3,96	8,51	6,8317	1,60633
Net profit per employee (in 000 dinars)	6	363,00	483,00	427,1667	47,89746
Valid N (listwise)	6				

Note: Author's calculation of with the application of SPSS

According to the given results, the statistical values of the cost of debt of trade in Serbia in observed period are: minimum – 3,96%, maximum 8,51% and average 6,83%. That same values for net profit per employee are following: minimum – 363,000, maximum 483,000, and average 427,167 (dinars). Table 8 shows the correlation between the cost of debt and net profit per employee of trade in Serbia for the period 2008-2013.

Table 8. Correlation between the cost of debt and net profit per employee, 2008-2013

		The cost of debt, (%)	Net profit per employee (000 dinars)
The cost of debt, (%)	Pearson Correlation	1	-,611
	Sig. (2-tailed)		,198
	N	6	6
Net profit per employee (000 dinars)	Pearson Correlation	-,611	1
	Sig. (2-tailed)	,198	
	N	6	6

Note: Author's calculation of with the application of SPSS

In the observed period there was significant negative correlation between the cost of debt and net profit per employee in trade of Serbia. (The results of regression analysis for the period 2008-2013 also show the significant impact of the cost of the debt per employee in trade enterprises in Serbia; Adjusted R Square ,217, Std. Error of the Estimate 42,39339, F 2,383, Sig. F ,198, Durbin-Watson 1,777) (Author's calculation with the application of SPSS). It means that efficient management of capital structure, financial leverage, netfinancial expenditures can improve competition and overall performance of trading enterprises in Serbia in the future.Considering the fluctuation of exchange rate in Serbia, the significant determinant of financial expenditure, i. e. profitability of all sectors, including trade is negative exchange difference. The transactions in Serbia are mostly expressed in Euros.

The fluctuation of average annual exchange rate (euro vs. dinar) in the period 2008 – 2013.was as follows: 2008 – 79,98, 2009 – 93,95, 2010 – 103,04, 2011 – 101,95, 2012 – 113,13, 2013 – 113,14. Table 9 shows the influence of exchange rate difference on financial expenditures and profitability (net profit per employee) in trade of Serbia for the period 2008-2013.

Table 9. Correlation (the influence of exchange rate on financial expenditures and profitability in trade of Serbia, 2008-2013

		Exchange rate	Share of financial expenditures in total revenues, (%)	Net profit per employee (000 dinars)
Exchange rate	Pearson Correlation	1	-,657	,754
	Sig. (2-tailed)		,157	,083
	N	6	6	6
Share of financial expenditures in total revenues, (%)	Pearson Correlation	-,657	1	-,737
	Sig. (2-tailed)	,157		,095
	N	6	6	6
Net profit per employee (000 dinars)	Pearson Correlation	,754	-,737	1
	Sig. (2-tailed)	,083	,095	
	N	6	6	6

Note: Author's calculation of with the application of SPSS

The data in the given table show that the exchange rate changes had significant negative correlation impact on financial expenditures, i. e. positive correlation on profit per employee as a measure of profitability of trade in Serbia.

3. CONCLUSION

The conducted comparative research in this work brings the following conclusion: the financial expenditures of trading enterprises are lower in countries with developed market economies than those in transition, such as Serbia. In other words, the efficiency of managing financial expenditures of trading enterprises in Serbia is on very low level compared to developed countries.

Such trend was affected by numerous factors, such as: high interest rate, indebtedness, negative exchange difference, high business risk, significant financial indiscipline etc. The efficient control of this and other factors can improve the efficiency of managing financial expenditures in the trading companies in Serbia in the future. Due to this, the strategy of the business should be defined. It will positively affect the competition and overall performance.

LITERATURE:

1. Abdou, H. A. et al. (2012). Determinants of capital structure in the UK retail industry: A comparison of multiple regression and generalized regression neural network. *Intelligent Systems in Accounting, Finance and Management*, 19(3), 151-169.
2. Anhin, H. and Wenhe, L. (Kamla-Raj 2014). A Study on Debt Sources Structure, Term

Structure and Investment Level of Listed Retail Companies.*Anthropologist*, 17(3), 769-775.
3. Berman, B. and Evans, J. R. (2010). *Retail Management*. Prentice Hall, Boston.
4. Chevalier, J. A. (1995). Capital Structure and Product-Market Competition: Empirical Evidence from the Supermarket Industry.*The American Economic Review*, 85(3), 415-435.
5. Gleason, K., Mathur, L., and Mathur, I. (2000). The Interrelationship between Culture, Capital Structure, and Performance: Evidence from European retailers. *Journal of Business research*, 50, 185-191.
6. Greuning, H. V., Scott, D. and Terblanche, S. (2011). *International Financial Reporting Standards, A Practical Guide*, Sixth Edition, The Washington, D.C.
7. Kaya, H. D. (March 2014). The Impact of Leverage on Trade Firm' Profitability and Liquidity Measures.*International Journal of Business and Social Science*, 5(3), 66-70.
8. Lee, B. (2014). *Capital Structure and Predation: Evidence fro Retail Industry*. McCombs School of Business, University of Texas, Austin, 1-42.
9. Levy, M. and Weitz, B. A. (2007). *Retailing Management*.McGraw-Hill, Irwin, Boston.
10. Li, C. et al. (2014). Working Capital Management, Corporate Performance, and Strategic Choices of the Wholesale and Retail Industry in China.*The Scientific Wold Journal*,
11. Little, P. L. et al. (2011). Evaluating the effect of recession on retail firms' strategy using DuPont method: 2006-2009. *Journal of Finance and Accountancy*, 7, 1-7.
12. Lukic, R. (2011). *Evaluacija poslovnih performansi u maloprodaji*. Ekonomski fakultet, Beograd.

LABOUR PRODUCTIVITY, REAL WAGES AND UNEMPLOYMENT: AN APPLICATION OF BOUNDS TEST APPROACH FOR TURKEY

Hacer Simay Karaalp-Orhan
Pamukkale University, Denizli
skaraalp@pau.edu.tr

ABSTRACT

This study investigates the relationship between labour productivity, average real wages, and the unemployment rate by employing the bounds testing procedure within an autoregressive distributed lag (ARDL) modeling approach and applies Toda-Yamamoto causality test for the period 2007:01−2016:04. The results indicate that real wages and unemployment have a significant and positive long-run impact on labour productivity. While a long-run wage–productivity elasticity of 0.97 supports the efficiency wage theorem and the unemployment-productivity elasticity of 0.53 indicates that workers increase efforts to secure jobs. Therefore, a rise in real wages and unemployment may induce higher productivity by raising the costs and probability of job loss, respectively, which implies rigidity in Turkish labour market. Furthermore, the causality tests provide evidence for the effect of a high and persistent unemployment rate on the Turkish economy, where unemployment affected both labour productivity and real wages. While a bi-directional causality was found between labour productivity and unemployment, a unilateral causality was observed between unemployment and real wages. Unemployment causes real wages, but there is no evidence of reversal causation.

Keywords: *Bounds testing procedure, Causality, Labour productivity, Real wages, Structural break, Unemployment*

1. INTRODUCTION

The relationship between productivity, real wages, and unemployment has been considered as one of the important issues in the economics literature. In macroeconomic perspective, with the effect of globalization and openness of countries to international trade, the growth of productivity and wages become crucial factors, which decide the international competitiveness between countries. The increase in productivity and competitiveness induces economic growth. This is especially true for the countries that are able to increase their welfare by the job creation concomitant with the economic growth. On the other side, there are many empirical studies that analyze the relationship between productivity-real wages and productivity-real-wage inflation rate. However, there are a few studies that examine the interrelationships among productivity, real wages, and unemployment. In this context, Alexander (1993) investigated the relationship between productivity, wages, and unemployment in the United Kingdom for the period 1955–91 by employing the cointegrating VAR methodology and the Granger causality. After finding the evidence of a structural break in 1979, the author divided the sample into two subperiods and stated that 'before 1979 unemployment is the central variable, being caused by both wages and productivity'; while after 1979 there is 'a strong bivariate causality between wages and productivity'. She related this shift to a change in the policy environment introduced by the then Prime Minister Margaret Thatcher. Wakeford (2004) also analyzed the relationship between productivity, real wages, and unemployment in South Africa by using cointegration and the Granger causality tests. The quarterly data comprise from 1983:Q1 to 2002:Q4. After finding evidence of a structural break in 1990, Wakeford divided the sample into two subperiods and found a long-term equilibrium (cointegrating) relationship between the real

wages and productivity for the two sub-periods. The results indicate that productivity has grown faster than real wages. Pazarlıoğlu and Çevik (2007) analyzed the relationship between productivity, real wages, and unemployment in Turkey by employing cointegration and causality tests for the period of 1945−2005. After finding evidence of a structural break in 1967, they also divided the sample into two subperiods and found the unemployment rate as the central variable being caused by both the wages and productivity rate for the period of 1945−1966. However, a unidirectional causality running from the unemployment to productivity and a bi-directional causality between the productivity and real wages were found for the period of 1969−2005, and then productivity became a central variable for the period of 1969−2005. They related this shift to a change in the competition of international trade through the impact of globalization, especially after the 1980s. Yusof (2007) examined the long-run and dynamic behaviors of real wage-employment-productivity relationship for the Malaysian manufacturing industry over the period of 1992:Q1− 2005:Q3. His findings indicate a long−run relationship between the variables. The theory that real wages inversely affect employment was not supported, while the performance-based pay scheme theory (but not the efficiency wage theory), was validated. Following the previous studies, the main objective of this one was to measure the relationship between average labor productivity, real wages, and the unemployment rate in Turkish manufacturing industry by using the autoregressive distributed lag (ARDL) approach to cointegration analysis and Toda-Yamamoto's (1995) causality tests. The quarterly dataset covers the period of 2007:01−2016:04. This study differs from the earlier ones in two ways. Firstly, an alternative cointegration and causality approach is used to test the relationship between the variables. Secondly, on the basis of empirical testing, this study attempts to shed some light on the labour market theories that dominate the Turkish manufacturing industry at present. In this context, this paper is structured as follows. Section 2 explains the theoretical background. Section 3 describes the data and methodology. Section 4 presents the empirical results and, finally, Section 5 concludes.

2. THEORETICAL BACKGROUND

The interrelationships between productivity, real wages, and unemployment are highly complex, with many feedback effects as well as ambiguous or multiple signs. Most well-known economics theories of the labour market, such as bargaining, search contract and efficiency wage theories try to explain these relationships

Table 1: The theoretical relationship between productivity, wages, and unemployment (Wakeford, 2004, p. 113)

Causal Direction	*Expected Sign*	*Rationale*
UR→PROD	+	*Workers increase effort to secure jobs;* *Less productive workers are fired first*
UR→RW	−	*Surplus labour weakens union bargaining power*
PROD→ RW	+	*Performance-based pay; bargaining*
PROD→ UR	+ −	*Greater efficiency implies reduced labour demand* *Positive output effect on employment*
RW → PROD	+	*Efficiency wages*
RW → UR	+	*Higher labour costs cause factor substitution*

Wakeford (2004) stated that the effect of an increase in average labour productivity on unemployment is ambiguous. Whereas, in the light of the commonly known labour market theories, and opposite effect of productivity on employment can be considered. If ceteris paribus, an increase in the productivity of workers could reduce the demand for labour and thus raise the unemployment rate. Contrary, an increase in the productivity of workers could

also reduce unemployment rate through the effect of output growth. As the efficiency of worker increases, the output and investment of firms also increase. Thus increased investments lead to labor demand and therefore productivity increase reduces unemployment rates. Conversely, unemployment affects productivity. High unemployment may induce workers not to shrink and increase their efforts. Therefore, workers' productivity will increase in order to secure their jobs. As less productive workers are usually the first to lose their jobs, increased unemployment may be associated with higher average productivity among the remaining workers. Therefore, this will cause the efficiency of workers to increase who are not the first to lose their jobs. The theories of wage bargaining imply that the unemployment rate affects wages in two ways. High unemployment rate weakens the bargaining power of union and therefore dampens the real wages. However, during the period of the low unemployment rate, unions can be able to offer high nominal wages (Pazarlıoğlu and Çevik, 2007, p.6). Secondly, if the individual pay is performance-based, the productivity will increase, this, in turn, will cause the real wages to increase (Alexander, 1993, p.87; Wakeford, 2004, p.113). Moreover, if real wages increase more than the productivity growth, unemployment arises, because firms prefer to substitute costly labour to capital. On the other hand, this substitution stemming from an increase in real wages will also increase marginal productivity (Wakeford, 2004, p. 113; Yildirim, 2015, p.89).

3. DATA AND METHODOLOGY

Following Alexander (1993, p.88) and Wakeford (2004, p.115), the long-run empirical model of labour productivity, real wages, and the unemployment rate could be specified as follows:

$$\ln LPROD_t = \gamma_0 + \gamma_1 \ln RW_t + \gamma_2 UR_t + \varepsilon_t \quad (1)$$

where $LPROD_t$ is labour productivity, RW_t is the real wages, UR_t is the unemployment rate and ε_t is the regression error term. While γ_1, the coefficient of RW_t, indicates the elasticity of productivity with respect to real wages, γ_2, the coefficient of UR_t, indicates the elasticity of productivity with respect to the unemployment rate. Theoretically, both variables are expected to have positive signs.

This study uses quarterly seasonal adjusted data for productivity, real wages, and the unemployment rate for 2007:1–2016:4 period. The productivity represents average labour productivity (production index/employment index) in the Turkish manufacturing industry. The real wages are obtained by deflating the nominal wage index with the consumer price index (CPI) (2000= 100). All data are obtained from the Turkish Statistical Institute (TURKSTAT). The variables are transformed into logarithmic form except for the unemployment rate.

In order to test the stationarity of variables and the integration and the possible cointegration among the variables, the augmented Dickey–Fuller (ADF) test (Dickey and Fuller, 1981) and an alternative Phillips–Perron (PP) unit-root test (Phillips and Perron, 1988) are employed. Following the stationarity tests, the bounds test for co-integration within ARDL modeling approach of Pesaran, Shin, and Smith (2001) was adopted to determine whether a long-run relationship exists between average labour productivity, real wages, and unemployment in Turkey. Since the bounds testing approach can be applied irrespective of the order of integration of the variables, the regressors can be I(1), I(0) or mutually cointegrated. First of all, for implementing the bounds test procedure the following ECM (error correction model) was estimated:

$$\Delta \ln LPROD_t = \alpha_0 + \sum_{i=1}^{p-1} \alpha_1 \Delta \ln LPROD_{t-i} + \sum_{i=1}^{p-1} \alpha_2 \ln RW_{t-i} + \sum_{i=1}^{p-1} \alpha_3 UR_{t-i} + \\ + \alpha_4 \ln LPROD_{t-1} + \alpha_5 \ln RW_{t-1} + \alpha_6 UR_{t-1} + \alpha_7 D + \mu_t \quad (2)$$

Equation (2) can be further transformed to accommodate the one period lagged error correction term (ECT_{t-1}) as in equation (3).

$$\Delta \ln LPROD_t = \alpha_0 + \sum_{i=1}^{p-1} \alpha_1 \Delta \ln LPROD_{t-i} + \sum_{i=1}^{p-1} \alpha_2 \ln RW_{t-i} + \sum_{i=1}^{p-1} \alpha_3 UR_{t-i} + \alpha_4 D + \lambda ECT_{t-1} + \mu_t \quad (3)$$

where Δ is first difference operator, *ln* is the log of the variables, and μt is the serially independent random error with zero mean and finite covariance matrix, and the deterministic term, constant, is denoted by α_0. In Equation (3), the parameter λ represents the long-run relationship and α_1 and α_2 represent short-run dynamics of the model. D is the dummy variable that represents the structural break period. In order to examine the long-run relationship between the dependent variable Y_t and its determinants, an F-test procedure is followed to estimate the combined significance of the coefficients of the lagged levels of the variables. While the null hypothesis is $H_0: \alpha_4=\alpha_5=\alpha_6=0$ (no cointegration) and the alternative hypothesis is $H1: \alpha_4 \neq \alpha_5 \neq \alpha_6 \neq 0$ (cointegration). If the null hypothesis is rejected, it indicates the existence of a long-run relationship or cointegration. Pesaran et al. (2001) provided a set of asymptotic critical values where the critical bounds can be applied irrespective of the order of integration of the regressors. The critical values are composed of two sets: lower bounds I(0) and upper bounds I(1). The first set gives the lower bound, applicable when all regressors are I(0). The second one gives the upper bound, applicable when all regressors are I(1) (Akkoyunlu and Siliverstovs, 2014:3240). If the calculated F-statistic exceeds the upper bound, the null hypothesis of no relationship between dependent variable Y_t and independent variables X_t can be rejected. Conversely, if the F-statistic falls below the lower bound, the null hypothesis of no long-run relationship cannot be rejected. However, if the F-statistic falls within the critical bounds, the result of cointegration will be inconclusive. According to Narayan (2005), the existing critical values reported by Pesaran et al. (2001) cannot be used for small sample sizes because they are based on large sample sizes for 500 and 1000 observations. Therefore, Narayan (2005) provided two sets of critical values for a given significance level with and without a time trend for small samples between 30 to 80 observations. Given the relatively small sample size in this study (40 observations), the hypothesis testing relies on the critical values simulated by Narayan (2005).As the last step, the Granger causality test is applied to examine the causal linkages between labor productivity, real wages, and unemployment. The notion of the Granger causality (Granger, 1969; Engle and Granger, 1987) is one of the most commonly and extensively used methods for evaluating the existence and direction of linkages among time series variables within vector autoregressive (VAR) models in economics literature (Pitarakis and Tridimas, 2003:362). According to Sims et al. (1990), the asymptotic distribution theory cannot be applied for testing causality of integrated variables in the level from using the VAR model even if the variables are cointegrated (see Clark and Mirza, 2006; Wolfe-Rufael, 2007:201). In this context, Toda and Yamamoto (1995) proposed an alternative approach that can be applied in the level VARs irrespective of whether the variables are integrated, cointegrated, or not. Toda and Yamamoto (1995), on the basis of augmented VAR(k) modeling, introduced a modified Wald test statistic that asymptotically has a chi-square (χ^2) distribution irrespective of the order of integration or cointegration properties of the variables in the model (Wolde-Rufael, 2007:201). The test has two steps: Firstly, in order to apply Toda and Yamamoto's approach (1995), it is essential to determine the true lag length (k) and the maximum order of integration (dmax) of the series under consideration. The modified Wald test statistic is valid regardless of whether a series is I(0), I(1) or I(2) non-cointegrated or cointegrated of an arbitrary order. The lag length, k, is obtained in the process of the VAR in levels among the variables in the system by using different lag length criterion such as AIC

(Akaike Information Criterion), SC (Schwarz Information Criterion), HQ (Hannan-Quinn Information Criterion), FPE (Final Prediction Error) and LR (Sequential Modified LR Test Statistic). Then the unit root testing procedure can be used to identify the order of integration (dmax). As the second step, the modified Wald test procedure is used to test the VAR(k) models for causality. The VAR(k) models are estimated by Ordinary Least Squares (OLS) estimation technique. Unlike the Granger causality test, Toda and Yamamoto's approach (1995) fits a standard vector auto-regression on the levels of the variables, not on the first difference of the variables (Wolde-Rufael, 2007:202). Therefore, to undertake Toda and Yamamoto's version (1995) of the Granger non-causality test, the following VAR system is presented:

$$\ln Y_t = \alpha_0 + \sum_{i=1}^{k} \alpha_{1i} \ln Y_{t-i} + \sum_{j=1}^{d\max} \nu_{1j} \ln Y_{t-j} + \sum_{i=1}^{k} \phi_{1i} \ln X_{t-i} + \sum_{j=1}^{d\max} \psi_{1j} \ln X_{t-j} + \lambda_{1t} \quad (4)$$

$$\ln X_t = \beta_0 + \sum_{i=1}^{k} \delta_{1i} \ln Y_{t-i} + \sum_{j=1}^{d\max} \theta_{1j} \ln Y_{t-j} + \sum_{i=1}^{k} \vartheta_{1i} \ln X_{t-i} + \sum_{j=1}^{d\max} \pi_{1j} \ln X_{t-j} + \lambda_{2t} \quad (5)$$

The null hypothesis that independent variable X_t does not cause dependent variable Y_t is constructed as follows: H0:ϕ1= ϕ2=…= ϕi =0. Similarly, in Equation (5), the null hypothesis that Y_t does not cause X_t is formulated as follows: H0=δ1= δ2=…=0.

4. EMPIRICAL RESULTS

Table 2 gives the ADF and PP unit root testing results of labour productivity, real wages, and unemployment. All of the series are non-stationary (contain a unit root) in their levels but are stationary in their first differences. Thus, they are integrated of order one, I(1).

Table 2: ADF and PP Tests for Unit Root

ADF				
	Level		First Difference	
	τ_μ	τ_η	τ_μ	τ_η
LPROD	–0.361[0]	–2.481[0]	–5.253[0]***	–5.185[0]***
RW	–0.634[0]	–1.848[0]	–5.341[0]***	–5.279[0]***
UR	–2.220[3]	–2.185[3]	–4.205[1]***	–4.141[1]**
PP				
	Level		First Difference	
	τ_μ	τ_η	τ_μ	τ_η
LPROD	0.059[8]	–2.570[3]	–5.023[10]***	–4.967[11]***
RW	–0.659[1]	–1.837[3]	–5.312[3]***	–5.198[4]***
UR	–1.647[2]	–1.619[2]	–3.387[6]**	–3.342[6]*

Note: All series are at their natural logarithms except the unemployment rate. $\tau\mu$ represents the model with a drift and without trend; $\tau\eta$ is the most general model with a drift and trend. The optimal lag lengths used in the ADF test are indicated within brackets and determined by the AIC. When using PP test, the values in brackets represent Newey-West Bandwidth (as determined by Bartlett Kernel). (*), (**) and (***) indicate that the corresponding coefficient is significant at 10%, 5%, and 1% levels, respectively.

The long-run relationship between labour productivity, real wages, and unemployment rate can be affected by the structural breaks/changes. In order to take this issue into account, the Chow breakpoint test (1960) was employed to identify the existence of an exogenously determined structural break time. The Chow test is applied for a linear model with one known single break in the mean. In this context, a limitation of the Chow test is that the breakdate must be known a priori. If the researcher picks an arbitrary or a known candidate break date, there may be two cases. Firstly, the Chow test may be uninformative, as the true breakdate can be missed. Secondly, the Chow test can be misleading, as the candidate breakdate is endogenous (it is correlated with the data) and the test is likely to indicate a break falsely when none in fact exists (Hansen, 2001, p.118). Therefore, the Quandt-Andrew test where the

breakdate is unknown a priori was introduced (Andrews, 1993; Quandt, 1960). This test examines one or more structural breakpoints in a sample. The null hypothesis is ‘‘no breakpoints”, and the test statistics are based on the Maximum (Max) statistic, the Exponential (Exp) Statistic, and the Average (Ave) statistic. In this study, to improve the accuracy of the estimation, the Quandt-Andrews breakpoint test (Quandt, 1960; Andrews, 1993) was adopted in combination with the Chow test (Chow, 1960).

Table 3: Stability Test Results

A. Quandt–Andrews unknown breakpoint test.		
Statistics	Value	p-Value
Max. LR F-stat. (2010:Q4)	67.6636	0.0000
Max. Wald F-stat. (2010:Q4)	202.9910	0.0000
Exp LR F-stat.	30.6467	1.0000
Exp Wald F-stat.	98.1296	1.0000
Ave LR F-stat.	31.3868	0.0000
Ave Wald F-stat.	94.1605	0.0000
B. The Chow breakpoint test result		
Null Hypothesis: No breaks 2010:Q4	67.663	F(3,34)=0.00

Table 3 reports the stability (break−point) test results. The Quandt–Andrews unknown breakpoint test compares 29 breakpoints and the null hypothesis of no break within the trimmed sample period is rejected by two of the three test statistics. The test is performed by using a trimming region of 15%. Hence, both tests suggest a structural break in 2010:Q4, which represents a significant economic growth after the 2008 financial crisis in Turkey. Since 2004, the Turkish economy showed a rapid economic growth of 9.4% in 2010. In this case, the influence of break can be captured as a dummy variable in the cointegration test. Following the results of unit root and stability tests, the long-run relationship between the variables can be investigated by using the bounds test to cointegration within the ARDL modeling approach developed by Pesaran et al. (2001). In this context, the lag length of the estimation is determined. The lag length that provides the smallest critical value is determined as the lag length of the model by using several lag selection criteria such as AIC, SC, HQ, FPE, and LR. According to the results of the selection criteria and considering the evidence of no residual autocorrelation, a value of 1 is preferred for the relationship between LPROD, RW, and UR. The calculated F-statistics for Equation (1) is found as 4.833, which is above the critical value. In this context, the null of no cointegration can be rejected at 10% level, implying that there exists a long-run relationship or cointegration between labour productivity, real wages, and unemployment rate.

Table 4: Results of Bounds Test for Cointegration

Model				F-statistic	
LPROD=f(RW, UR)					
Calculated F Statistic				4.833	
Narayan (2005)				k=2, T=40	
90%level		95%level		99%level	
I(0)	I(1)	I(0)	I(0)	I(1)	I(0)
3.373	4.377	4.113	5.260	5.893	7.337

Notes: (*), (**), and (***) indicate that the corresponding coefficient is significant at 10%, 5%, and 1% levels, respectively. Critical values are citied from Narayan (2005:1988) (Table Case III: Unrestricted intercept no trend)

After establishing the cointegration relationship for Equation (1), the next step is to estimate the long-run coefficients of the equation by using the ARDL specification. Owing to the

ARDL specification, it is assumed that the errors are serially uncorrelated and the, maximum lag is selected as 1 according to the lag length criteria, where no autocorrelation is found in Equation (1). The estimated long-run coefficients of ARDL(1,1,1) model are given in Table 5.

Table 5: Estimated Long-Run Coefficients Using ARDL Approach

Regressors	ARDL(1,1,1)
Constant	0.076 [0.122]
RW	0.970 [2.429]**
UR	0.535 [1.853]*
DUMMY_2010	1.582 [2.710]**

Note: t-values are given in parentheses. (*), (**) and (***) indicate that the corresponding coefficient is significant at 10%, 5%, and 1% levels, respectively.

The long-run coefficients show that all regressors in the productivity equation exhibit the positive sign and are statistically significant at the 5% or higher level. The results imply the importance of real wages in labour productivity in the long-run. The long-run coefficient of real wages is positive and strongly statistically significant at 5% level. A 1% increase in the real wages increases the labour productivity by 0.97%. The findings support the efficient wage theory in Turkish manufacturing industry in the long-run. Moreover, the unemployment rate also affects labour productivity in the long-run. A 1% increase in unemployment rate increases the labour productivity by 0.53%. The results indicate that high unemployment leads to increase workers' performance because less productive workers are fired first. To sum up, the results found that both real wages and unemployment positively affect labour productivity in the long-run.

The error correction model was also estimated within the ARDL framework. The results of the short-run dynamic coefficients related to the long-run relationships estimated by Equation (1) are reported in Table 6.

Table 6: Error Correction Model

Regressors	ARDL(1,1,1)
Dependent variable: $\Delta LPROD_t$	
Constant	0.009[0.127]
ΔUR	–0.451[–6.604]***
ΔRW	–0.588[–5.463]***
DUMMY_2010	0.195 [1.867]*
ECT_{t-1}	–0.171[–2.550]**
Adjusted R^2: 0.79 DW:2.31 F=25.188(0.000)	
$\chi^2_{LM}(1) = 0.242$	$\chi^2_{ARCH}(1) = 0.604$
$F^{RESET}_{(1,31)} = 0.247[0.622]$	$\chi^2_{NORM}(2) = 0.649[0.722]$

Note: t-values are given in parentheses. (*), (**), and (***) indicate that the corresponding coefficient is significant at 10%, 5%, and 1% levels, respectively. The statistics are distributed as chi-squared variates with the degrees of freedom in parentheses.

The results for 2007:Q1–2016:Q4 period show that the error correction term, ECT_{t-1}, is negative and statistically significant, indicating that the feedback mechanism is effective in Turkey. In other words, the convergence to long-run equilibrium after a shock is relatively small for the Turkish manufacturing industry. The estimated coefficient of error correction term (–0.17) indicates that around 5% of the deviation from equilibrium is eliminated within a quarter. However, the sign of the short-run coefficients is negative except dummy variable and statistically significant in productivity equation. The model passes the specification tests, such as the tests of no residual autocorrelation, no residual ARCH effects, residual normality, and no residual heteroscedasticity and the RESET test for functional form misspecification.

The cumulative sum (CUSUM) and the cumulative sum of squares (CUSUMQ) tests were employed to determine whether the parameters in the models are stable. The results of CUSUM and CUSUM-Q tests are shown in Figure 1. The lines show the boundaries of 5% significance levels. It can be seen in the figures that the parameters are stable; the sum of the squared residuals lies inside the critical bounds of 5% significance.

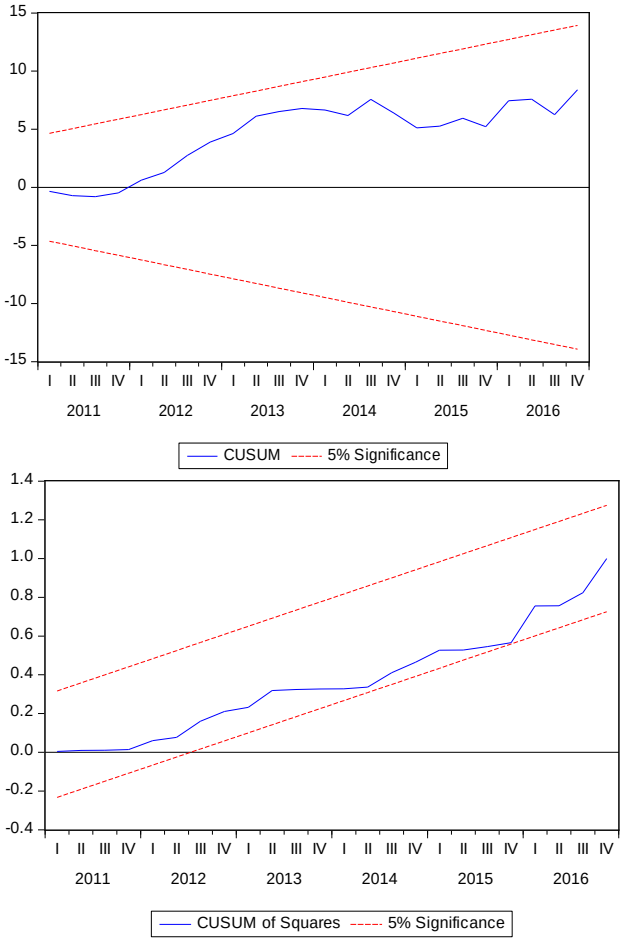


Figure 1: CUSUM and CUSUM Q Test Results for Coefficient Stability

Toda and Yamamoto's procedure (1995), which employs a modified Wald test does not require pre-testing for the cointegrating properties of the system and is valid regardless of whether a series is *I(0), I(1)* or *I(2),* non-cointegrated or cointegrated in an arbitrary order 'as long as the order of integration of the process does not exceed the true lag length of the model' (Toda and Yamamoto, 1995:225; Wolde-Rufael, 2007:202). Therefore, the results of Toda−Yamamoto's version (1995) of the Granger causality test are presented in Table 7.

Table 7: The Results of Toda-Yamamoto's Causality Test

Null Hypothesis	χ_p^2 -statistic	Probability value	Decision
UR does not cause LPROD	14.958	0.001	Bidirectional Causality UR↔ LPROD
LPROD does not cause UR	12.508	0.005	
RW does not cause LPROD	5.930	0.115	No Causality
LPROD does not cause RW	2.684	0.442	
RW does not cause UR	3.355	0.340	Unidirectional Causality UR → RW
UR does not cause RW	9.394	0.024	

Notes: (*), (**), and (***) indicate that the corresponding coefficient is significant at 10%, 5%, and 1% levels, respectively. VAR is estimated by [k + dmax] =4 for the model, optimal lag length k=3 is selected by lag length criteria, dmax=1.

According to Toda-Yamamoto's causality test results shown in Table 7, it can be concluded that the causal relationship between productivity and unemployment is bi-directional. However, there exists a unidirectional causality running from the unemployment to real wages. In other words, a bi-directional causality is found from unemployment to labour productivity. A causality running from unemployment to labour productivity is found at the 5% level of significance but there is no evidence of reversal causation running from labour productivity to unemployment. The results imply a significant effect of the unemployment rate on the Turkish economy. Unemployment has been the central variable, being caused by both real wages and productivity for the period of 2007:01−2016:04.

5. CONCLUSION

This study has empirically investigated the relationship between labour productivity, average real wages, and the unemployment rate in Turkey using quarterly data from 2007 to 2016. The empirical results evidence a structural break at the end of 2010. The break−date, which indicates the rapid economic growth of Turkish economy, appears to have positively affected the relationship between the variables. The cointegration results indicate a long-run equilibrium relationship between the real wages, unemployment, and productivity. While a long-run wage-productivity elasticity of 0.97 implies the efficiency of wage theorem in Turkish manufacturing industry; a long-run unemployment-productivity elasticity of 0.53 implies the increasing efforts and thus the productivity of workers to secure their jobs. The positive effects of real wages and unemployment together on the labour productivity also indicate the rigidity of Turkish labour market. Furthermore, the causality tests indicate the importance of unemployment rate in Turkey, where unemployment affected both real wages and labour productivity. A bi-directional causality was found between labour productivity and the unemployment rate. There exists a feedback effect between the variables. High unemployment increases the productivity of workers who do not want to lose their jobs. Contrary, the productivity causes unemployment. If the productivity that leads to increase the output does not induce the investments, then sufficient employment opportunities are not created in the economy and, thus the unemployment rate continues to increase. The same effect was found in the Turkish economy, especially soon after the 2008 economic crisis. However, a unilateral causality was found between the real wages and unemployment. Unemployment causes real wages, but the absence of the reversal causation implies a broken link. Increasing labour supply affects the formation of wages. According to the theoretical expectations, if the unemployment rate is to rise, one may expect to weaken union bargaining power and the wages. However, one may mention the decreasing unionization of workers and thus decreasing bargaining power of the unions in Turkish industry. As a result, the findings indicate that the unemployment still remains an important macro−economic issue in Turkey. A high and persistent unemployment rate has been one the structural macroeconomic problems of Turkey. During the aforementioned period, the average unemployment rate reached to 10.1%. Although the Turkish economy performed a rapid economic growth right after the 2008 economic crisis, the strong economic growth performance could not be sustained in the following years and thus sufficient employment opportunities could not be created (Karaalp-Orhan and Gülel, 2016, p.152). Therefore, unemployment appears to have a clear effect on labour productivity and real wages in Turkey.

LITERATURE:

1. Andrews, D. W. K. (1993) Tests for parameter instability and structural change with unknown change point, Econometrica, 61, 821–56.

2. Akkoyunlu, S., Siliverstovs, B. (2014). Does The Law of One Price Hold in A High-Inflation Environment? A Tale of Two Cities in Turkey. *Applied Economics*, 46(26), pp. 3236–3245.
3. Alexander, C.O. (1993). The Changing Relationship between Productivity, Wages and Unemployment in the UK. *Oxford Bulletin of Economics and Statistics*, 55(1), pp.87–102.
4. Clark, J. A., Mirza, S. (2006). A Comparison of Some Common Methods of Detecting Ganger Noncausality.*Journal of Statistical Computation and Simulation*,76(3),pp.207–231.
5. Chow, G. C. (1960). Tests of Equality between Sets of Coefficients In Two Linear Regressions. *Econometrica*, 28(3), pp. 591–605.
6. Dickey, D. A., Fuller W.A. (1979). Distribution of the Estimators for Autoregressive Time Series with A Unit Root. *Journal of the American Statistical Association*, 74(366), pp.427–431.
7. Engle, R.F., Granger, C.W.J. (1987).Co-integration and Error Correction: Representation, Estimation and Testing. *Econometrica*, 55(2), pp. 251–276.
8. Granger, C.W.J. (1969). Investigating Causal Relations by Econometric Models and Cross Spectral Models. *Econometrica*, 37(3), pp. 424–438.
9. Hansen, B. E. (2001). The New Econometrics of Structural Change: Dating Breaks in U.S. Labour Productivity. *Journal of Economic Perspectives*, 15(4), pp. 117–128.
10. Karaalp-Orhan, H.S., Gülel, F. (2016). The Impact of the Global Financial Crises on Regional Unemployment in Turkey. *International Journal of Economic Perspectives*, 10(1), pp.151–160.
11. Narayan, P.K. (2005). The saving and Investment Nexus for China: Evidence from Cointegration Tests. *Applied Economics*, 37(17), pp. 1979–90.
12. Pazarlıoğlu, V., Çevik, E.İ. (2007). Verimlilik, Ücretler ve İssizlik Oranları Arasındaki İliskinin Analizi: Türkiye Örnegi. *Yönetim ve Ekonomi*, 14(2), pp. 1–17.
13. Pesaran, M.H., Yongcheol, S., Smith R.S. (2001). Bounds Testing Approaches to the Analysis of Level Relationships. *Journal of Applied Econometrics*, 16, pp. 289–326.
14. Phillips, P.C.B., Perron, P. (1988). Testing For A Unit Root in Time Series Regression. *Biometrica*, 75, pp. 335–346.
15. Pitarakis, J.Y.,Tridimas G.G. (2003). Joint Dynamics of Legal and Economic Integration in the European Union. *European Journal of Law and Economics*, 16(3), pp. 357–368.
16. Quandt, R.E. (1960). Models of Transportation and Optimal Network Construction. *Journal of Regional Science*, 2(1), pp. 27–45
17. Sims, C.A., Stock, J.H., Watson, M.W. (1990). Interference in Linear Time Series Models with Some Unit Roots. *Econometrica*, 58(1), pp. 113–144.
18. Toda, H.Y., Yamamoto, T. (1995). Statistical Inference in Vector Autoregressions with Possibly Integrated Process. *Journal of Econometrics*, 66(1–2), pp.225–250.
19. Wakeford, J. (2004). The Productivity-Wage Relationship In South Africa: An Empirical Investigation. *Development Southern Africa*, 21(1), pp.109–132
20. Wolde-Rufael, Y. (2007). "Another Look at the Relationship between Telecommunications Investment and Economic Activity in the United States. *International Economic Journal*, 21(2), pp.199–205,
21. Yildirim, Z. (2015). Relationships among Labour Productivity, Real Wages and Inflation in Turkey, *Economic Research-Ekonomska Istraživanja*, 28(1), pp.85–103,
22. Yusof, S.A. (2008). The Long-Run and Dynamic Behaviors of Wages, Productivity and Employment in Malaysia. *Journal of Economic Studies*, 35(3), pp.249 – 262

FDI, ECONOMIC PERFORMANCE AND TECHNOLOGICAL SPILLOVER EFFECTS: EVIDENCE FROM UAE

Haifa Al Hamdani
University of East Anglia
H.al-hamdani@uea.ac.uk

Emiliya Lazarova
University of East Anglia
E.Lazarova@uea.ac.uk

Corrado Di Maria
University of East Anglia
C.Di-Maria@uea.ac.uk

ABSTRACT

This study is an attempt to empirically examine the impact of foreign direct investment (FDI) on economic performance and investigate the spillover effects from the FDI inflows in the United Arab Emirates (UAE), using a detailed sectoral-level panel dataset covering the period 2006 – 2014. The main empirical finding indicates that FDI has a mixed impact on economic performance in UAE and this effect depends on the sectoral characteristics and geographical destinations. In contrast, the results further show that the FDI from more technologically advanced countries tend to have a positive impact on economic activity. The findings suggest that the FDI inflows from countries with far distance of UAE seem to bring high benefit quality of technology.

Keywords: *Economic Performance, Foreign Direct Investment, Panel Data, UAE, Spillover*

1. INTRODUCATION

Today's world is witnessing a sizable volume of FDIs flowing into different countries. In 2000 the global FDI flow was around US 1.4 trillion and in 2015 reaching US 1.7 trillion, according to UNCTAD World Investment Report 2016. Therefore, much attention has been given to the impact of FDI on the economy. FDI is believed to have played a major role in intensifying the interaction between firms across several countries. Attracting FDI has become a focus of attention for developing countries as a development strategy.

FDI inflows been regarded as having a beneficial impact on developing host countries, since "FDI drives reform, improves quality of life and ultimately brings prosperity" (Dubai Investment Development Agency). FDI has been suggested to be beneficial for the hosting country at different levels. It creates a flow of capital across borders seeking higher rates of return. It can spread best practices in corporate governance and management. It allows the transfer of technology and know-how as well as promotes competition in the domestic input market along with the firm's development and reorganization (Moura & Forte 2009). This argument is particularly relevant for horizontal FDI spillover effects. The hosting country of FDI will gain employee training while operating the new businesses, which eventually contributes to the development of human capital. Apart from the inflow of foreign currency into a country, foreign expertise can be an important factor in improving the existing technical processes in the country as well as improving productivity and competitiveness, and the efficiency of resources. It increases trade flows and creates jobs, which will reduce unemployment. FDI increases opportunities for local businesses and eventually promotes innovation. The impact of FDI on economic performance has largely been explored empirically at both macro and micro levels. These studies have been inspired by theories of

the Solow-type standard neoclassical growth models. FDI is conceived as an addition to the capital stock of the recipient economy (Brems, 1970). In other words, the impact of FDI on the economic growth is similar to the one of domestic capital. Therefore, FDI will not have a lasting impact on the growth rate taking into consideration the diminishing returns to capital. Interestingly, despite the proposition of the theories, there are ambiguity in the literatures on the role of FDI on economic performance; while some studies find positive effect of FDI on the economic growth (for example, Borensztein, De Gregorio, and Lee, 1998; Woo, 2009) others find negatively effects or its unclear (for example, Aitken and Harrison, 1999; Alfaro, et al., 2004). At macro level, Li and Liu (2005) find that the share of FDI inflows in the GDP positively effects economic growth. In addition, by using sectoral level data, Khaliq and Noy (2007) discover at the aggregate level FDI does have a positive impact on economic growth. Also in regards FDI and domestic firms, Aitken and Harrison (1999) show FDI in the same firm would decrease the productivity of the host country domestic firms. FDI is also related to improvement in productivity in host countries productivity as captured by Total Factor Productivity (TFP) has also been studied. For example, Woo (2009) find the FDI flow in Gross Domestic Product (GDP) increases the TFP growth. Alfaro, et al., (2004), on the other hand, show no impact of FDI on TFP growth, but there is indirect positive impact through financial government. The effect of FDI through the distance to frontier, Sjoholm (1999) finds higher technology distance to frontier is good for domestic firm to get high benefit from FDI inflows by increasing the value added per employee. On the other hand, Li and Liu (2005) discover that larger technology distance to frontier prevent the positive effects of FDI as per as the negative significant sign of the interaction term of the distance to frontier with the FDI variable (to test whether the effect of FDI on income growth depend of the technology distance to frontier). As in case of indirect effect from FDI, studies have been influenced by theories of technological spillovers. Theories identify several spillovers channels, imitation of technological production of multinational corporations by the domestic firms (Das, 1987; Wang and Blomstrom,1992); hiring workers of FDI firms by domestic firms to transfer the new technology –labour turnover (Aitken and Harrison, 1999; Fosfuri, Motta and Rønde, 2001). Some studies yield ambiguous results on spillovers from FDI, Javorcik (2004) reports that positive spillover effects Lithuanian productivity from the FDI. In contrast, Haddad and Harrison (1993) discover that the technological spillovers appeared strongly in high tech sector and vanished in law tech sectors.Motivated by these literature disagreements, we look to macro analysis of FDI on economic performance and spillover effects. This paper studies the impact of FDI on economic performance and investigates the geographical and sectoral extent of FDI horizontal technology spillovers and diffusion, using the UAE as a case study. Interestingly, UAE is one of the countries that trying to attract the FDIs to it and win their advantages via following appropriate economic policies, utilizing financial and funding several incentives and advantages in order to push forward and develop its investment climate. In particular, our goal in this paper is to take a sectoral approach and investigate what type of FDI by origin and sectoral destination are more beneficial to the UAE's economy. We carry out an empirical examination of the relationship between the inflows of FDI and at sectoral level economic performance in UAE. We extend standard analyses by controlling for the distance between the source of FDI and recipient by weighted the source composition of FDI. We further study FDI spillovers along geographical and sectoral dimensions as channels of technological diffusion. We use detailed dataset of FDI that contains information on both the origin and the destination of FDI by emirate and industry over the 2006-2014 period. To the best of our knowledge, this is the first paper about FDI distance to frontier that explains the economic performance. Previous papers have used distance to technological frontier level but this paper the researcher will be using sectoral level weighted to distance index and FDI distance to frontier in order to explain the UAE

economic performance and horizontal technology spillovers from FDI inflows into UAE. Which gets advantages spillovers account for heterogeneity across sectors and inter sectoral country level giving the better technological frontier of FDI at each sector. Our empirical study finds that FDI has different effect on the economic performance depending on location. Attracting FDI from source countries that have less distance from UAE is better than FDI from high distance of source countries and FDI inflows from very far distance of source countries brings higher quality technology to UAE. Sectoral spillover effects of FDI as the highest in primary sector (which is content one sector; Mining and Quarrying), which primary sector affects the value added of the UAE more than other sectors spillovers. The results so far suggest that positive effect of FDI depends on the absorptive capacity of the destination.

2. LITERATURE REVIEW

A number of hypotheses have been offered regarding the interaction and relation between FDI and economic performance. Review the economic arguments and empirical evidence on the direct and indirect contributions of FDI on economic growth. Firstly, the direct effect of FDI on economic performance, there are studies that show that FDI has a positive impact on developing economies. Borensztein, De Gregorio, and Lee (1998) empirically examined the role of FDI in diffusing technology and growing developing economies and find out that FDI does have a positive overall effect on economic growth. They also investigate whether the inflow of foreign capital crowds out domestic investment. Per capital GDP growth was the dependent variable and their results indicate that FDI contribute to expanding domestic investment by the complementarity of production or by raising the productivity of the developing. The impact of FDI happens at two levels: through capital accumulation in the hosting economy and through knowledge transfers. The direct effect in terms of capital accumulation, technology and long run, following the neoclassical approach to growth, the capital accumulation can affect growth only in the short run (Solow, 1956 and 1957). In terms of the long run growth is possible by a permanent increase in the level of technology which is as exogenous in neoclassical growth model. However, endogenous growth models are considering technology to be endogenous – determined within the models - and see a role for capital in the creation of technological advances (Romer, 1990). FDI is expected to increase knowledge in the recipient economy through training and skill acquisition as well as improving management practices. This positive impact of FDI on the economy of the hosting country is improving the economic growth; however, is this flow of capital helping all the sectors in the hosting economy or will there be sectors suffering at the expense of others. Campos and Kinoshita (2002), state that transition economies from centrally planned to market economy such as Central and Eastern European as well as the former Soviet Union had a complete industrial structure and a relatively educated labour force which enabled them to benefit from FDIs. If the host economy does not have an acceptable educational level in its labour force this might result an increase in the unemployment rate as the investing country might resort to non-local labour, at least until the local labour force bridges the skills gap. Several studies use aggregate of cross-sectional of countries and most findings were in the direction positive relationship between FDI and economic growth. De Gregorio (1992) uses panel data of 12 countries in Latin American, and finds that the effect of foreign investment on GDP growth is about three times larger than for domestic investment. Li and Liu (2005) identify a significant endogenous relationship between FDI and economic growth based on a panel of data for 84 countries over the period of 1970 and 1979. In their research they apply both single equation and system estimations to study this relationship. They find that FDI enhances economic growth through its interactions with human capital. The relation between human capital and FDI has a positive impact on economic growth of developing countries.

According to Liu and Agbola (2014), FDI inflows enhance economic growth. The authors use an economic growth model to examine the impact of inward FDI on regional economic growth. Moreover, they stress that an open-door policy attracts foreign capital inflows, which in return results in knowledge transfer into the host country. A country such as China has been known to implement preferential policy as a means of encouraging the inflow of FDI into their economy. China is among the largest beneficiary of FDI globally. The authors state that economic growth is promoted by technological advancement that enhances the marginal profit on capital. Based on this, the authors argue that FDI acts as a channel that allows the flow of foreign technology and knowledge. The literature on FDI also reveals a non-positive impact on the recipient economy. FDI can have a crowding out effects in host country economy which results from the monopoly power over the market gained by multinational companies. There is a mixed empirical evidence regarding that. A negative wage effects can result of an FDI especially if multinationals hire the best workers due to their high wages and leave lower-quality workers at the domestic firms (Lipsey and Sjoholm, 2004). Another strand of the literature has focused on sectoral-level analyses. This literature differentiates between direct and indirect effects of FDI on the host economy. Direct effects are reflected in employment and capital formation and indirect effects are reflected through management practices. In other words, FDI can benefit the hosting economies in several sectors. Alfaro and Charlton (2007) examine the effect of FDI using sectoral data from OECD member countries during 1990 – 2001 for 19 sectors and 22 countries. They study the impact of FDI on economic growth using sectoral data. The model uses Cobb Douglas production function in log form. It was observed that there is a difference across sectors. They notice that FDI causes a crowding in effect on real estate, oil and chemical, machinery, construction, and trade and repair are positive whereas those on other sectors were not statistically significant. They conclude that the impact of FDI on economic growth is not equally distributed across sectors. Therefore, it is crucial to understand the implications of the sectoral composition of FDI with respect to its impact in the hosting economy. FDI contributes to the sectors in different ways in terms of motivation, financing and linkages to the rest of the economy. For example, the service sector includes different activities such as finance, infrastructure, wholesale and retail as well as tourism. Studying the effect of FDI by sectors could explain the lack of robust results on economic growth. For instance, the impact of FDI on the primary sector is not always positive. A number of authors have looked at the role of distance from the frontier and FDI. Aiming to boosting productivity and foster economic growth is an economic policy context specific and depending on country's distance to the international technological frontier. Distance to frontier is usually measured by the ratio or difference between a country's productivity measures which is usually the TFP. In Neo-Schumpeterian growth theory there is a key that the economics are influenced by a country's income gap with the advanced economies that describe the international technological frontier (Aghion and Howitt, 2009). The larger distances of distance to frontier can associate countries to exploit the technologies from advanced and developed country (foreign firms). Furthermore, Vandenbussche, Aghion, and Meghir (2006) examine the contribution of human capital to economy-wide technological improvements. They show that when labour is skilled they produce a higher growth effect closer to the technological frontier taking into consideration that innovation is a more relatively skill-intensive activity than imitation. Secondly, in terms of the indirect effect of FDI on economic performance by technological spillover effects, Branstetter (2005) examines the spillovers of technological information resulting from FDI. He finds that FDI increases the flow of knowledge spillovers at the firm level. The empirical framework uses patent citations data by measuring knowledge flows from American to Japanese firms. Knowledge spillovers seem to be strongest through R&D and product development facilities. Although the fact that FDI is expected to improve growth in the

hosting country through technological and knowledge spillover, the degree to which FDI enhances growth depends on the degree of complementarity and substitution between FDI and domestic investment (De Mello, 1999). Das (1987), uses a price-leadership model based on oligopoly theory to examine the transfer of technology from the foreign firm to its subsidiary abroad. The analyse realises that due to the effect of spillovers from foreign firms subsidiary which have better technology, the domestic firms learn from foreign firms and become more efficient and efficiency would be costless to them also increase host country benefits. According to Fosfuri, Motta and Rønde (2001), find after focusing on the costliness of technology transfer deals with technological spillovers through worker mobility, that the spillovers can take place when foreign firms can transfer technology only after training the domestic workers and then those workers are hired by domestic firms. A number of existing literature on the subject of the technology spillover effects, we distributed them on geographical and sectoral spillover dimensions. It has been suggested recently that FDI spillovers have a circumscribed geographical dimension or, at least, that they decrease with distance (Audretsch and Feldman, 1996; Audretsch, 1998; Keller, 2002; Madariaga and Poncet, 2007), as channels of technological diffusion are reinforced at the regional level (Girma and Wakelin, 2001; Girma, 2003; Torlak, 2004; Jordaan, 2005). Using geographical dimension to classify and quantify FDI spillovers. Since knowledge may decay with distance, geographical spillover plays a significant role in knowledge diffusion and innovation (Wang, Lin, & Li, 2010). Meanwhile, geographical proximity is identified as an essential condition for firms or sectors to enjoy the benefits of externality, collaboration and interactions for knowledge and flows and transfer technology (Boschma, 2005). Geographical distance determines the costs of technology diffusion, it measures by destination and firm sector and this measure of FDI presence when focusing on the FDI spillover effects, within the same geographic location and firm. The geographical interactions are shaped as from one location to its neighbours, and then neighbours' neighbours, and finally to the original location. Findlay (1978) was one of the FDI spillovers theory inventors. He built a model to examine the relationship between FDI and technological change in a backward region following Gerschenkron (1962). In brief, the larger the distance to frontier and technological gap between the foreign firms and domestic firms, the larger the spillovers effects. Also he finds that the larger the share of foreign firms in backward regions, the faster the efficiency growth of backward firms. This theory indicates that larger distances to technology of foreign firms are good for host countries. The more domestic firms attract foreign firms, the more benefit they can get because of the spillovers effects. In terms of sectoral spillover, FDI effects take place within and across sectors. Besides, FDI potential in aggregating productivity effect varies across sectors. Several of macroeconomic studies investigating FDI effects on economic growth and the results remain inconclusive and unclear, these studies do not distinguish between different sectors where FDI is operating and that would hide the relationships that appears within and across sectors. There are various reasons to estimate that the productivity effects of FDI vary across sectors. This paper will examine the impact of FDI on economic performance in the UAE in order to explore the relationship and find out if it's positive or negative. As well as investigate the geographic spillover effects of FDI in the UAE in the three emirates and the 14 sectoral spillover effects which has been classified as primary spillover, secondary spillover and tertiary spillover to identify and quantify FDI spillovers in the UAE.In order to achieve our objectives, the structure of this paper is as follows: the next section discusses the model and the data set and section 4 concludes.

3. EMPRICAL STRATEGY AND PRELIMINARY RESULTS

This paper intends to examine whether FDI has an impact on economic performance of 14 sectors in the three destinations in the UAE.

The base line regression model is:

$$\ln VA_{ikt} = \beta_0 + \beta_1 FDI_{ikt-1} + \beta_2 \ln K_{ikt-1} + \beta_3 \ln L_{ikt-1} + \alpha_i + \delta_k + \lambda_t + \varepsilon_{ikt} \quad (1)$$

Where the subscripts i,k and t denote emirate, sector and year, VA is the value added, respectively, all controls are in lags to avoid problems of endogeneity.
To estimate the effect of FDI on economic performance, we use fixed effect regressions. α_i is Emirate fixed effect to control for variables that vary across emirate but constant over time and sector, δ_k is sector fixed effect to control for variables that vary across sector but constant overt time and emirate; and λ_t is time fixed effect to control for variables that vary across time but constant across emirate and sector. We include the measure of technological distance of FDI portfolio. The regression model becomes:

$$Ln\,VA_{ikt} = \beta_0 + \beta_1 FDI_{ikt-1} + \beta_2 \ln K_{ikt-1} + \beta_3 \ln L_{ikt-1} + \beta_4 FDIAD_{ikt-1} + \beta_5 FDIDXB_{ikt-1} + \beta_6 FDIPrim_{ikt-1} + \beta_7 FDISecond_{ikt-1} + \beta_8 Dist_{ikt-1} + \beta_9 FDIDist_{ikt-1} + \alpha_i + \delta_k + \lambda_t + \varepsilon_{ikt} \quad (2)$$

Where $FDIAD$ stands for the interaction between FDI and Abu Dhabi indicator variable, $FDIDXB$ is the interaction term between FDI and Dubai indicator, $FDIPrim$ stands for the interaction between FDI and primary sector indicator, and $FDISecond$ stands for the interaction between FDI and secondary sector indicator. Where $Dist$ stands for technological distance and $FDIDist$ stands for the interaction between FDI and Dist. We use geographical distance of FDI inflows from the source countries to an emirate to identify and quantify FDI spillovers by constructing and modifying the geographical spillover excluding that to the sector. Then, we add the measure of technology distance of FDI portfolio and the interaction between FDI and technology distance. The regression model becomes:

$$Ln\,VA_{ikt} = \beta_0 + \beta_1 FDI_{ikt-1} + \beta_2 \ln K_{ikt-1} + \beta_3 \ln L_{ikt-1} + \beta_4 GeoSpill_{ikt-1} + \beta_5 Dist_{ikt-1} + \beta_6 FDIDist_{ikt-1} + \alpha_i + \delta_k + \lambda_t + \varepsilon_{ikt} \quad (3)$$

Where $GeoSpill$ is the geographical spillover. To measure the sectors spillovers effects, we construct the FDIs for sectors for example: the primary sector spillover constructed from the total of the three sectors spillover (Primary, Secondary and Tertiary) to investigate the sectoral spillovers and sectors spillovers important relative with the value added. Then, we conclude the measure of technology distance of FDI portfolio and the interaction between FDI and technology distance. The regression model becomes:

$$Ln\,VA_{ikt} = \beta_0 + \beta_1 FDI_{ikt-1} + \beta_2 \ln K_{ikt-1} + \beta_3 \ln L_{ikt-1} + \beta_4 PrimSpill_{ikt-1} + \beta_5 SecondSpill_{ikt-1} + \beta_6 TertSpill_{ikt-1} + \beta_5 Dist_{ikt-1} + \beta_6 FDIDist_{ikt-1} + \alpha_i + \delta_k + \lambda_t + \varepsilon_{ikt} \quad (4)$$

Where $PrimSpill$ stands for primary sector spillover, $SecondSpill$ stands for secondary sector spillover, and $TertSpill$ stands for tertiary sector spillover. Data on sectoral value added (VA), FDI, Gross Fixed Capital Formation (GFCF) (K) and labour (L) of 14 sectors of each emirate destination in the UAE are obtained from the fDi intelligence, Federal

Competitiveness and Statistics Authority – UAE, Statistics Centre - Abu Dhabi and Dubai Statistics Center. As data on GDP (2000 base year AED), GFCF and labour for world countries are attained from World Bank's World Development Indicators (Constant 2005 US$). The dataset is annual and covers the period of 2006-2014. The three destinations of the UAE are Abu Dhabi, Dubai and North Emirates. North Emirates contents five emirates are: Sharjah, Ajman, Umm Al-Quwain, Fujairah and Ras Al Khaima. Hence, the 14 sectors are classified as a classical breakdown to three main activities of economic sectors in our estimations. First, Primary sector, which includes Mining and quarrying (includes crude oil and natural gas). Then, Secondary sector contains Manufacturing, Electricity, gas, and water supply; waste management, and Construction. Third, is the Tertiary sector, which consists Wholesale and retail trade; repair of motor vehicles and motorcycles, Transportation and storage, Accommodation and food services, Information and communication, Financial and insurance, Real Estate, Administrative and support services, Education, Human health and social work, and Arts, recreation and other services. Data on GFCF for Dubai and North Emirates cover only contain 13 sectors, Administrative and support services sector data was missing entirely from the group of tertiary sector between the period of 2006-2014. Data in local currency – Arab Emirates Dirhams (AED) have been converted to US dollars using fixed exchange rate (1 USD = 3.67 AED), and then deflated by GDP– value added, adjusted all variables to have 2006 values. GFCF and labour variables are taken in their natural logarithms to reduce the problems of heteroscedasticity to the maximum possible extent. Value added is also in natural logarithm. Data from World Bank's World Development Indicators have been used to calculate the technological distance of the FDI portfolio to calculate TFP, we use data on GDP (GDP at market prices (constant 2005 US$)), GFCF (Gross fixed capital formation (constant 2005 US$)) and labour force in total, to this end TFP is first calculated. TFP, its measures the efficiency of the economy in transforming inputs into outputs, TFP calculated by multiplying the ratio of output to labour input as a weighted average of capital and labour productivity.

$$TFP_{jt} = \left(\frac{Y_{jt}}{L_{jt}}\right)\left(\frac{L_{jt}}{K_{jt}}\right)^{0.35} \quad (5)$$

The subscript j denotes source country of FDI capital investment. In our data there are 76 source countries, so we need to calculate TFP values for each year for the source country and UAE.

From equation (14), we didn't have capital stock K in the World Bank's World Development Indicators, we had to use implementary perpetual inventory method in order to calculate initial value of capital (k_0).

$$k_0 = \frac{I_1}{g+\delta} \quad (6)$$

Where I denotes investment, g denotes average growth rate (the mean of GDP growth over the period of available data countries, and δ denotes depreciation rate as we have taken this to be 0.06.

$$k_t = (1-\delta)\,k_{t-1} + I_t \quad (7)$$

Where t = 1, …, T

In regards distance to the frontier calculation, was taking the sum of FDI capital investment share per country, year and sector multiply it by the TFP for the same country, year and sector then divide that sum by UAE TFP for the same year and sector. Following equation shows the distance to frontier to figure the technological intensity:

$$Dist_{ikt} = \frac{\sum_{j \in 5} \frac{FDI_{ijkt}}{\sum_{j \in 5} FDI_{ijkt}} TFP_{jt}}{TFP_{UAE_t}} \quad (8)$$

Where:
i = Emirate
k = Sector
t = Year
j = source
$\mathbb{5}$ = set of source countries

We construct the FDI inflows in each emirate from the total FDI inflows in all UAE destinations for the 9 years from 2006 to 2014; to measure the geographical spillover effect across emirate region and between sectors on that period of time. And to estimate the sectoral spillover effects, we construct the sectoral spillover of the three main sectors (primary, secondary and tertiary). Primary sector spillover is conducted by the share of primary FDIs inflow from the total of FDI inflows across the three emirates destinations in the UAE. The other sectors spillovers have been calculated as the same way of primary sector spillover calculation.

As a summary statistics, we have in total 378 observation content 14 sectors, 3 emirates and 9 years. As in some sectors we do not have information on capital, we have 360 observations in total of capital. In regards FDI, the min FDI is zero. FDI equals of 103 observations. If we look at average FDI across the sectors in which FDI is positive it is 317.71 million (2000 US$). The highest value added registered in Mining and Quarrying sector in Abu Dhabi in 2014 and in terms of the lowest value added, North Emirates is lowest in Arts, recreation and other services sector in 2006. The distance was only computed for 275 observations, where FDI was positive with 219 observations only, means that 56 observations with no TFP to be computed for any of the source countries and for the distance calculation. In some cases when distance of FDI portfolio was calculated, TFP was not available for some of the source countries. In these cases two approaches were taken. First, distance was calculated using the original weight but the weights did not sum to 1; and second, the weight of the source countries were recalculated to reflect only those countries for which TFP is available. For some observations Dist has a value < 1 and for others it's >1. Dist below 1, means the average of the source countries has TFP which is lower than TFP of UAE in that year. In regards, distance above 1, its mean the weighted average of TFP of the source countries is much above the TFP of UAE in that year. The highest distance is in Dubai in 2010 in Construction sector and the lowest distance is in North emirates in Mining and Quarrying sector in 2014. Geographical spillover, primary sector spillover, secondary sector spillover and tertiary sector spillover their min are zeros. Zero's geographical spillover are 80 observations, Zero's primary sector spillover are 131 observations, Zero's secondary sector spillover are 98 observations and Zero's tertiary sector spillover are 100 observations. The highest geographical spillover in 2007 in Mining and Quarrying sector. In regards the sectoral spillover, secondary sector is the highest spillovers in Abu Dhabi emirate in 2012 compared with primary and tertiary sectors. The correlation between FDI and geographical spillover is close to zero, suggests no linear correlation between FDI and geographical spillover. Concerning sectoral spillover, all sectors spillovers have weak relation even with FDI and value added.

The purpose of empirical investigation is to examine the impact of FDI on value added, to investigate the FDI and its technological intensity's impact on economic performance in the UAE by measuring the distance to technological frontier of FDI flows in UAE and to explore

the geographical and sectoral extent of FDI technology spillover and associated spatial diffusion. In particular, the paper also examines whether the effect of FDI interacts with emirate destinations and interacts with sector type. The main regression results indicate that FDI has a mixed impact on economic performance- sectoral value added, and that the magnitude of this effect depends on the emirate destination and sectors. The results of panel data have been reported in Tables 1-4. Table 1, the effects of capital, worker and Primary are positive and statistically significant in all specifications. Moreover, capital and worker have positive and statistically significant relation with the value added. In specification 4.1, if 1% increase in capital that will lead 0.31% increasing in value added, holding all else constant. Also, the 1% increasing in number of worker will lead 0.35% increasing in value added, holding all else constant. In addition, the magnitude of the effect is similar in specification 4.2, 4.5 and 4.8, but once we control for sector fixed effect we see that the coefficient of worker increases and data of capital decreases. This is more relies in line with the literature on production function where labour share is usually twice that of capital. But here we do not control for any fixed effect and therefor, the results may be biased. We add fixed effect in subsequent models and we test for the significance of the fixed effects. From specification 4.2 - 4.4 we see that the fixed effects are always statistically significant and the introduction of sectoral level fixed effect reduces the significant and the magnitude of the coefficient of FDI. Our goal is to look deeper on the impact of FDI and the regression analysis. We study whether FDI has a different impact of value added depending of the location and /or sector. In 4.5, we see whether FDI has different effect depending on the location. The interaction terms between FDI and Abu Dhabi, FDI and Dubai are not statistically significant either individually or in group. Similar results we obtain in 4.8. In 4.9, however, when we also control for time fixed effect, we see the interaction terms are jointly significant at 1% level and indicate that FDI has a higher effect on value added in both Abu Dhabi and Dubai compared to North Emirates. Further testing shows that the effect of FDI in value added in North Emirates and Abu Dhabi is not statistically significant different from zero, but the effect of FDI on value added in Dubai is positive and statistically significant. In the spirit of Alfaro and Charlton (2007), we test for differential effect of FDI through different sectors. We interact FDI with sector classification primary and secondary. We see that the FDI impact on value added in primary sector is significantly higher than the FDI impact on value added in tertiary sector or secondary sector. In 4.8, we also have evidence that FDI impact on value added in the secondary sector is higher that tertiary sector. Finally comparing 4.8 and 4.9, we see that time fixed effects are not statistically significant in 4.9, and that indicates our preferred regression model should be 4.8. Table 2 as we added distance and the interaction term between FDI and distance. We study also whether FDI has a different impact of value added depending on the distance. The interaction terms between FDI and distance is not statistically in all specifications except 5.6 and 5.11. The main goal of testing this equation is distance has a different impact of value added depending on the FDI. Distance is negative in all specifications, means increasing the distance of FDI, decrease the value added conditional on the amount of FDI, capital, labour in sectors. Which indicates bringing and attracting FDI from source countries that have less distance is better. As there can be collinearity which explains the lower significance level for FDI and FDIDist, we do a joint hypothesis test on these coefficients we find that 5.8 and 5.9 specifications which is statistically significant and have the same results even when we added time effect in 5.9 which the time fixed effect is not significance. We also interact FDI with distance, the interaction terms is positive which means that if distance increase, the effect of FDI on value added becomes higher and positive, our positive results of FDI go in line with empirical findings of Li and Liu (2005) and Woo (2009) that also discover positive effects from FDI on economic growth in cross country studies. That indicates, the FDI from very far distance brings higher quality

technology, with this finding we confirm theoretical proposal of Wang and Blomtrom (1992). FDI is significant in specification 5.8 – 5.11, in these specifications there is no such sector. For FDI to have positive effect on value added its source 5.10 should have distance higher 5.12. The joint effect of FDI distance is jointly significant. The purpose of to examine the geographical spillover of FDI after measuring the technological distance to frontier of FDIs inflow and add the interaction with FDI and distance. Table 3 The interaction of primary and secondary sectors is positive and statistically significant in all specifications, which means that if distance increase, the effect of FDI on value added becomes higher and positive. That an indication of the fact that distance located further away from the frontier are catching up the diffuse technological at a faster level. That's in line with Findlay (1978) empirically findings, the larger the distance to frontier of the foreign firms, the larger the spillover effects. Finally comparing 6.7 and 6.8, we see that time fixed effect is not significant in 6.8, and this indicates our preferred regression model should be 6.7. Table 4 presents the sectoral spillovers for the three main sectors (primary spillover, secondary spillover and tertiary spillover). Emirate and sector fixed effects is significant in all specifications and time fixed effect is not. Comparing 7.3 and 7.4, even by adding time fixed effect, the results stay the same, Emirate and sector fixed effect are positive and statistically significant and the interaction of sectoral spillovers stays insignificant. In regards the distance and the interaction term between FDI and distance in 7.5 – 7.8, Distance is negative and statistically significant relation with the value added but the interaction of FDI and distance is negative and not significant in these mentioned specifications.

4. CONCLUSION

This paper has examined the impact of FDI on economic performance and to explore the geographical and sectoral extent of FDI technology spillover and associated spatial diffusion in UAE, using sectoral level panel data and production function model to examine the links between FDI, value added and the distance that measures technological intensity in a panel of three destinations among UAE and 14 sectors over the period 2006-2014. The empirical study finds contradict results on the proposed effect of FDI has different effect on value added (Aitken & Harrison, 1999; Alfaro, et al., 2004; Keller, 2004; Keller & Yeaple, 2009; Woo, 2009) depending on the location, which FDI has a higher effect on value added in both Abu Dhabi and Dubai compared to North Emirates. Attracting FDI from source countries that have less distance from UAE is better than FDI from high distance of source countries and FDI flows from very far distance of source countries brings higher quality technology to UAE. This is reflected in the significance of the interaction terms of FDI with emirate, and sector type. The significance of the variable that proxies for technological distance of the FDI source also points in that direction. The geographical spillover effects are a distance located further away from the frontier are catching up the diffuse technological at a faster level, and in terms of sectoral spillover effects of FDI are highest in primary sector (Mining and Quarrying) which primary sector affects the value added of the UAE more than other sectors spillovers. The results so far suggest that positive effect of FDI depends on the absorptive capacity of the destination.

ACKNOWLEDGEMENT: *Haifa Al Hamdani: **"**I am grateful to Dr. Emiliya Lazarova and Dr. Corrado Di Maria for their guidance, support and motivation"*

LITERATURE:

1. Aitken, Brian J., and Ann E. Harrison. (1999). Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela, *American Economic Review*, 89(3), 605-618.

2. Alfaro, L., & Charlton, A. (2007). Growth and the quality of foreign direct investment: is all fdi equal?, Harvard Business School Working Paper 07-072.
3. Borensztein, E., De Gregorio, J., & Lee, J. W. (1998). How does foreign direct investment affect economic growth?. *Journal of International Economics*, *45*(1), 115-135.
4. Branstetter, L. (2006). Is foreign direct investment a channel of knowledge spillovers? Evidence from Japan's FDI in the United States. *Journal of International economics*, *68*(2), 325-344.
5. Campos, N. F., & Kinoshita, Y. (2002). Foreign direct investment as technology transferred: Some panel evidence from the transition economies. *The Manchester School*, *70*(3), 398-419.
6. Cobb, C.W., & Douglas, P.H. (1928). A Theory of Production. *American Economic Review*,18:139-165.
7. Das, S. (1987). Externalities, and Technology Transfer through Multinational Corporations: A Theoretical Analysis. *Journal of International Economics*, Vol. 22(1-2), pp. 171-182.
8. De Gregorio, J. (1992). Economic growth in Latin America. *Journal of Development Economics* 39, 58–84.
9. De Mello, L. R. (1999). Foreign direct investment-led growth: evidence from time series and panel data. *Oxford Economic Papers*, *51*(1), 133-151.
10. Dunning, J.H. (1977). Trade, location and economic activity and the multinational enterprise: a search for an eclectic approach In Ohlin, B., P. Hesselborn, & P. Wijkman, editors, *The International Allocation of Economic Activity*. London: MacMillan.
11. Dunning, J.H. (1992). Multinational enterprises and the global economy. Wokingham, UK and Reading, MA: Addison-Wesley Publishing Company.
12. Dunning, J. H. (1993). Multinational Enterprises and the Global Economy, Wokinghan England, Addison-Wesley.
13. Du, D. (2009). Research and development of multinational corportations in China: Growth, influences and policy suggestions. Beijing: Science Press (in Chinese).
14. Findlay, R. (1978). Relative Backwardness, Direct Foreign Investment and the Transfer of Technology: A Simple Dynamic Model. *Quarterly Journal of Economics* 92: 1-16.
15. Fosfuri, A.; M. Motta and T. Rønde (2001), Foreign Direct Invesment and Spillovers Through Workers' Mobility, *Journal of International Economics*, Vol. 53, pp. 205-222.
16. Girma, S. and Wakelin, K. (2001) Regional Undervelopment: Is FDI the Solution? A Semi-Parametric Analysis. GEP Research Paper No. 1001/11, University of Nottingham.
17. Javorcik, B. S., & Spatareanu, M. (2008). To share or not to share: Does local participation matter for spillovers from foreign direct investment?. *Journal of development Economics*, *85*(1), 194-217.
18. Jordaan, J. (2005) Determinants of FDI-Induced Externalities: New Empirical Evidence for Mexican Manufacturing Industries. *World Development*, 33(12), pp. 2103-2118.
19. Keller, W. (2002) Geographical Localization and International Technology Diffusion. *American Economic Review*, 92(1), pp. 120-142.
20. Keller, W. (2004). International Technology Diffusion. *Journal of Economic Literature*, 42, 752-782.
21. Keller, W., & Yeaple, S. R. (2009). Multinational Enterprises, International Trade, and Productivity Growth: Firm Level Evidence from the United States. *Review of Economics and Statistics*, 91(4), 821-831.
22. Khaliq, A., & Noy, I. (2007). Foreign direct investment and economic growth: Empirical evidence from sectoral data in Indonesia. *University of Hawaii at Manoa, Department of Economics Working Paper*, (200726).

23. Lipsey, R.E. & Sjöholm, F. (2004a). 'Foreign Direct Investment, Education, and Wages in Indonesian Manufacturing'. *Journal of Development Economics* 73: 415-422.
24. Madariaga, N. and Poncet, S. (2007) FDI in Chinese Cities: Spillovers and Impact on Growth. *The World Economy*, 30(5), pp. 837-862.
25. Romer, Paul. (1990). Endogenous technological change. *Journal of Political Economy*. 98: S71 S102.
26. Solow, R.M., (1957). Technical Change and the Aggregate Production Function. *The Review of Economics and Statistics 39*, p.312-320.
27. Solow, Robert M. (1956). A contribution to the theory of economic growth. *Quarterly Journal of Economics.* 70: 6594.
28. Vandenbussche, J., P. Aghion, & C. Meghir. (2006). "Growth, Distance to Frontier and Composition of Human Capital." *Journal of Economic Growth* 11:97–127.
29. Wang, & Blomstrom, M. (1992). Foreign investment and technology transfer. *European Economic Review*, 36(1), 137-155.

APPENDICES

Table 1: Value added and FDI

Ln value added	4.1	4.2	4.3	4.4	4.5	4.6	4.7	4.8	4.9
FDI_{t-1}	0.0002*** (0.0001)	0.0003*** (0.000)	0.0001 (0.0001)	0.0000 (0.0001)	-0.0004 (0.0005)	0.0003*** (0.0001)	0.0003** (0.0001)	-0.0007 (0.0004)	-0.0005 (0.0003)
Ln $capital_{t-1}$	0.3109*** (0.0465)	0.3277*** (0.0519	0.2087*** (0.2620)	0.1993*** (0.0235)	0.3444*** (0.0532)	0.2699*** (0.0366)	0.2664*** (0.0383)	0.3597*** (0.0541)	0.2832*** (0.0366)
Ln $labour_{t-1}$	0.3480*** (0.0369)	0.3356*** (0.0348)	0.7044*** (0.0718)	0.8015*** (0.0700)	0.3279*** (0.0351)	0.4614*** (0.0388)	0.4676*** (0.0386)	0.3470*** (0.0346)	0.4582*** (0.0391)
$FDIAD_{t-1}$					0.0006 (0.0006)			0.0007 (0.0005)	0.0005 (0.0004)
$FDIDXB_{t-1}$					0.0008 (0.0006)			0.0009 (0.0005)	0.0009 (0.0003)
Primary						1.7440*** (0.2047)	1.7451*** (0.2097)	1.7440*** (.2047)	1.7606*** (0.2126)
Secondary						0.1055 (0.1009)	0.0858 (0.1053)	0.1055* (0.1009)	0.0643 (0.1081)
$FDIPrim_{t-1}$						-0.0002* (0.0001)	-0.0003* (0.0001)	0.0005* (0.0003)	-0.0002 (0.0001)
$FDISecond_{t-1}$						-0.0002 (0.0001)	-0.0002 (0.0002)	-0.0000* (0.0002)	0.0000 (0.0002)
Constant	2.3138*** (0.4415)	2.1576*** (0.4668)	-1.3412 (0.8225	-2.2431** (0.8256)	2.2881*** (0.4754)	1.0463* (0.5025)	1.1894* (0.5537)	2.0392*** (0.5118)	1.3348* (0.5565)
Fixed Effects									
Emirate (F-test)	NO	YES (9.41***)	YES (57.59***)	YES (60.03***)	YES (7.04***)	YES (11.70***)	YES (11.22***)	YES (6.32***)	YES (9.53***)
Sector (F-test)	NO	NO	YES (94.10***)	YES (123.29***)	NO	NO	NO	NO	NO
Year (F-test)	NO	NO	NO	YES (2.81***)	NO	NO	YES (0.37)	NO	YES (0.36)
Interaction Terms									
Primary/ secondary (F-test)	NO	NO	NO	NO	NO	YES (36.27***)	YES (34.66***)	YES (35.84***)	YES (34.42***)
FDIPrim/ FDISecond (F-test)	NO	NO	NO	NO	NO	YES (2.18)	YES (2.11)	YES (1.40)	YES (1.01)
FDIAD/ FDIDXB (F-test)	NO	NO	NO	NO	YES (1.27)	NO	NO	YES (1.77)	YES (3.56***)
Observations	231	231	231	231	231	231	231	231	231
R-squared	0.4318	0.4839	0.9067	0.9158	0.4926	0.6104	0.6154	0.5061	0.6257

* p<0.1, ** p<0.05, *** p<0.01
Robust standard errors in parenthesis under coefficients

Table 2: Value added, FDI and Distance

Ln value added	5.1	5.2	5.3	5.4	5.5	5.6	5.7	5.8	5.9	5.10	5.11
FDI_{t-1}	0.0001 (0.0001)	0.0001 (0.0001)	0.0000 (0.0001)	0.0000 (0.0001)	-0.0007 (0.0006)	-0.0001 (0.0002)	0.0001 (0.0001)	-0.0010** (0.0004)	-0.0011** (0.0003)	-0.0010** (0.0004)	-0.0011** (0.0004)
$Dist_{t-1}$	-0.5399*** (0.1615)	-0.5330*** (0.1491)	-0.0465 (0.0702)	-0.0252 (0.0774)	-0.5942*** (0.1519)	-0.0691 (0.0801)	-0.4965*** (0.1324)	-0.0762*** (0.0848)	-0.6049*** (0.14299)	-0.5709*** (0.1282)	-0.6138*** (0.1385)
$FDIDist_{t-1}$	0.0002 (0.0003)	0.0002 (0.0003)	0.0001 (0.0001)	0.0001 (0.0001)	0.0004 (0.0003)	0.0002* (0.0001)	0.0002 (0.0002)	0.0004 (0.0003)	0.0004 (0.0003)	0.0004* (0.0002)	0.0004* (0.0003)
Ln $capital_{t-1}$	0.2774*** (0.0512)	0.2703*** (0.0540)	0.2542*** (0.2707)	0.2341*** (0.0243)	0.3002*** (0.0562)	0.2404*** (0.0260)	0.2687*** (0.0439)	0.3049*** (0.0424)	0.2942*** (0.0424)	0.3040*** (0.0371)	0.2978*** (0.0377)
Ln $labour_{t-1}$	0.3237*** (0.5197)	0.3065*** (0.0425)	0.6620*** (0.0861)	0.7766*** (0.0833)	0.2891*** (0.0433)	0.7616*** (0.0857)	0.4219*** (0.0444)	0.4016*** (0.0449)	0.4105*** (0.0443)	0.4028*** (0.0445)	0.4107*** (0.0437)
$FDIAD_{t-1}$					0.0003 (0.0007)	-0.0001 (0.0002)		0.0005 (0.0005)	0.0006 (0.0005)	0.0006 (0.0004)	0.0006 (0.0005)
$FDIDXB_{t-1}$					0.0009 (0.0006)	0.0001 (0.0002)		0.0011*** (0.0004)	0.0012*** (0.0004)	0.0011*** (0.0004)	0.0012*** (0.0004)
Primary							1.4067*** (0.2308)	1.4130*** (0.2178)	1.4611*** (0.2297)	1.4190*** (0.2073)	1.4360*** (0.2135)
Secondary							-0.0379 (0.1242)	-0.1090 (0.1337)	-0.0852 (0.1365)	-0.0512 (0.1016)	-0.0641 (0.1037)
$FDIPrim_{t-1}$							-0.0001 (0.0001)	0.0001 (0.0001)	-0.0000 (0.0001)		
$FDISecond_{t-1}$							-0.0001 (0.0002)	0.0002 (0.0002)	0.0001 (0.0002)		
Constant	3.2374*** (0.5197)	3.1771*** (0.5215)	-1.0613 (0.9662)	-2.1080* (0.9684)	3.3915*** (0.5433)	-1.9361* (0.9895)	1.8742*** (0.6155)	2.1515*** (0.6131)	2.3718*** (0.6619)	2.1346*** (0.6064)	2.3500*** (0.6491)
Fixed Effects											
Emirate (F-test)	NO	YES (10.63***)	YES (33.64***)	YES (37.50***)	YES (7.82***)	YES (29.32***)	YES (10.86***)	YES (10.68***)	YES (3.26***)	YES (10.95***)	YES (9.64***)
Sector (F-test)	NO	NO	YES (67.21***)	YES (81.63***)	NO	YES (83.00***)	NO	NO	NO	NO	NO
Year (F-test)	NO	NO	NO	YES (2.87***)	NO	YES (2.71***)	NO	NO	YES (0.88)	NO	YES (0.93)
Interaction Terms											
Primary/ secondary (F-test)	NO	NO	NO	NO	NO	NO	YES (19.22***)	YES (22.69***)	YES (21.66***)	YES (23.71***)	YES (22.90***)
FDIPrim/ FDISecond (F-test)	NO	NO	NO	NO	NO	NO	Yes (0.33)	Yes (0.37)	Yes (0.09)	NO	NO
FDIAD/ FDIDXB (F-test)	NO	NO	NO	NO	YES (1.81)	YES (2.84***)	NO	YES (5.12***)	YES (5.67***)	YES (5.71***)	YES (6.65***)
FDIDist / FDI	YES (1.07)	YES (2.05)	YES (0.76)	YES (0.74)	YES (0.99)	YES (1.84)	YES (1.23)	YES (2.84***)	YES (2.98***)	YES (3.36***)	YES (3.80***)
Observations	178	178	178	178	178	178	178	178	178	178	178
R-squared	0.4292	0.4948	0.8972	0.9107	0.5114	0.9133	0.6005	0.6234	0.6917	0.6872	0.6877

Table 3: Value added, FDI, Distance and Geographical spillover

Ln value added	6.1	6.2	6.3	6.4	6.5	6.6	6.7	6.8
FDI_{t-1}	0.0001 (0.0001)	-0.0000 (0.0001)	0.0000 (0.0001)	0.0000 (0.0001)	0.0001 (0.0001)	-0.0000 (0.0001)	0.0000 (0.0001)	0.0000 (0.0001)
Ln $capital_{t-1}$	0.2703*** (0.0544)	0.2812*** (0.0401)	0.2716*** (0.0391)	0.2639*** (0.0399)	0.2703*** (0.0544)	0.2812*** (0.0401)	0.2716*** (0.0391)	0.2639*** (0.0399)
Ln $labour_{t-1}$	0.3077*** (0.0433)	0.4462*** (0.0473)	0.4219*** (0.0442)	0.4293*** (0.0437)	0.3077*** (0.0433)	0.4462*** (0.0473)	0.4219*** (0.0442)	0.4293*** (0.0437)
Geo $Spill_{t-1}$	0.0000 (0.0001)	0.0001 (0.0001)	0.0000 (0.0001)	0.0000 (0.0001)	0.0000 (0.0001)	0.0001 (0.0001)	0.0000 (0.0001)	0.0000 (0.0001)
AD emirate	0.6729*** (0.1505)		0.5992*** (0.1404)	0.6287*** (0.1426)	0.6729*** (0.1505)		0.5992*** (0.1404)	0.6287*** (0.1426)
DXB emirate	0.1429 (0.1695)		0.0874 (0.1309)	0.1127 (0.1335)	0.1429 (0.1695)		0.0874 (0.1309)	0.1127 (0.1335)
Primary		1.4180*** (0.2599)	1.3689*** (0.2104)	1.3771*** (0.2193)		1.4180*** (0.2599)	1.3689*** (0.2104)	1.3771*** (0.2193)
Secondary		-0.1204 (0.1054)	-0.0796 (0.0998)	-0.0910 (0.1015)		-0.1204 (0.1054)	-0.7968 (0.0998)	-0.0910 (0.1015)
$Dist_{t-1}$	-0.5244*** (0.1516)	-0.4941*** (0.1384)	-0.5031*** (0.1285)	-0.5295*** (0.1344)	-0.5244*** (0.1516)	-0.4941*** (0.1384)	-0.5031*** (0.1285)	-0.5295*** (0.1344)
$FDIDist_{t-1}$	0.0002 (0.0003)	0.0001 (0.0002)	0.0002 (0.0002)	0.0002 (0.0002)	0.0002 (0.0003)	0.0001 (0.0002)	0.0002 (0.0002)	0.0002 (0.0002)
Constant	0.1342*** (0.5465)	1.7660*** (0.0002)	1.8701*** (0.6209)	2.0891** (0.6673)	3.1342*** (0.5465)	1.7660*** (0.6398)	1.8701*** (0.6209)	2.0891*** (0.6673)
Fixed Effects								
Year (F-test)	NO	NO	NO	YES (0.74)	NO	NO	NO	YES (0.74)
Emirate (F-test)	YES (10.53***)	NO	YES (10.64***)	YES (10.83***)	YES (10.53***)	NO	YES (10.65***)	YES (10.83***)
Interaction Terms								
Primary/ secondary (F-test)	NO	YES (15.81***)	YES (21.84***)	YES (20.35***)	NO	YES (15.81***)	YES (21.84***)	YES (20.35***)
FDIDist / FDI	YES (0.60)	YES (0.20)	YES (0.89)	YES (0.83)	YES (1.60)	YES (0.20)	YES (0.89)	YES (0.83)
Observations	178	178	178	178	178	178	178	178
R-squared	0.4953	0.5476	0.6000	0.6141	0.4953	0.5476	0.6000	0.6141

* p<0.1, ** p<0.05, *** p<0.01
Robust standard errors in parenthesis under coefficients

Table 4: Value added, FDI, Distance and Sectoral spillover

Ln value added	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8
FDI_{t-1}	0.0001*	0.0000	0.0000	0.0000	0.0001*	0.0000	0.000	0.0000
	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Ln $capital_{t-1}$	0.2708***	0.2861***	0.2659***	0.2638***	0.2708***	0.2861***	0.2659***	0.2638***
	(0.0556)	(0.0391)	(0.0412)	(0.0425)	(0.0556)	(0.0391)	(0.4126)	(0.0425)
Ln $labour_{t-1}$	0.3058***	0.4449***	0.4221***	0.4275***	0.3058***	0.4449***	0.4221***	0.4275***
	(0.0435)	(0.0471)	(0.0447)	(0.0438)	(0.0435)	(0.0471)	(0.0447)	(0.0438)
Prim $Spill_{t-1}$	-0.0001	0.0000	0.0000	-0.0000	-0.0001	0.0000**	0.0000	-0.0000
	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0000)	(0.0001)
Second $Spill_{t-1}$	-0.0001	0.0001	0.0000	-0.0001	-0.0000	0.0002	0.0000	-0.0001
	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Tert $Spill_{t-1}$	0.0000	-0.0001*	-0.0000	0.0000	0.0000	-0.0001**	-0.0000	0.0000
	(0.0001)	(0.0000)	(0.0001)	(0.0001)	(0.0001)	(0.0000)	(0.0001)	(0.0001)
AD Emirate	0.6819***		0.6122***	0.6701***	0.6819***		0.6122***	0.6701***
	(0.1717)		(0.1634)	(0.1704)	(0.1717)		(0.1634)	(0.1704)
DXB Emirate	0.1380		0.1883	0.1586	0.1380		0.1883	0.1586
	(0.2573)		(0.2264)	(0.3611)	(0.2573)		(0.2264)	(0.3611)
Primary		1.4791***	1.3881***	1.3384***		1.4791***	1.3881***	1.3384***
		(0.2625)	(0.2246)	(0.2361)		(0.2625)	(0.2246)	(0.2361)
Secondary		-0.0607	-0.0619	-0.1261		-0.0607	-0.0619	-0.1261
		(0.1134)	(0.1076)	(0.1177)		(0.1134)	(0.1076)	(0.1177)
$Dist_{t-1}$	-0.5434***	-0.5250***	-0.5115***	-0.5309***	-0.5434***	-0.5250***	-0.5115***	-0.5309***
	(0.1478)	(0.1353)	(0.1271)	(0.1350)	(0.1478)	(0.1353)	(0.1271)	(0.1350)
$FDIDist_{t-1}$	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002
	(0.0003)	(0.0002)	(0.0002)	(0.0002)	(0.0003)	(0.0002)	(0.0002)	(0.0002)
Constant	3.1969***	1.8204***	1.9288***	2.1590***	3.1969***	1.8204***	1.9288***	2.1590***
	(0.5747)	(0.6523)	(0.6569)	(0.6860)	(0.5747)	(0.6523)	(0.6569)	(0.6860)
Fixed Effects								
Emirate (F-test)	YES (8.91***)	NO	YES (8.23***)	YES (9.10***)	YES (8.91***)	NO	YES (8.23***)	YES (9.10***)
Year (F-test)	NO	NO	NO	YES (0.82)	NO	NO	NO	YES (0.82)
Sector (f-test)	NO	YES (16.39***)	YES (19.82***)	YES (17.87***)	NO	YES (16.39***)	YES (19.82***)	YES (17.87***)
Interaction Terms								
Spillover primary/secondary/tertiary (F-test)	YES (0.56)	YES (2.32*)	YES (0.17)	YES (0.25)	YES (0.56)	YES (2.32)	YES (0.17)	YES (0.25)
FDIDist / FDI	YES (2.60*)	YES (0.72)	YES (0.99)	YES (0.65)	YES (2.60*)	YES (0.72)	YES (0.99)	YES (0.65)
Observations	178	178	178	178	178	178	178	178
R-squared	0.5000	0.5588	0.6013	0.6157	0.5000	0.5588	0.6013	0.6157

* p<0.1, ** p<0.05, *** p<0.01
Robust standard errors in parenthesis under coefficients

THE NEWLY AMENDED SHAREHOLDERS RIGHTS DIRECTIVE: LOTS OF RIGHTS, WHAT ABOUT IMPLEMENTATION?

Hana Horak
Faculty of Economics and Business, University of Zagreb, Croatia
hhorak@efzg.hr

ABSTRACT
The newly amended Shareholders' Rights Directive (SRD) after quite a long period of negotiations is on the table. There are lots of issues and requirements addressed by the new SRD in order to encourage shareholder long-term engagement and increase transparency. The SRD contains provisions on shareholders' rights to vote on remuneration policy identification of shareholders and facilitation of exercise of shareholders rights. The SRD provides rules that foster transmission of information, transparency for institutional investors, asset managers and proxy advisors and related party transactions. The Member States will have up to two years to incorporate new provisions into the national law. The SRD recognizes different models of corporate governance which is a step forward in regulating such important issues. One of the main questions is power of the directive as a legal instrument in enforcing shareholders' rights in future 27 different national company laws of the Member States. This paper will provide analysis of legal solutions within the SRD and possible shortcomings and problems within the implementation in different company laws and corporate governance models in Member States.
Keywords: *EU company law, Shareholders' Rights Directive*

1. INTRODUCTION

Shareholders have always been in the focus of EU Company law and corporate governance. Their rights have been regulated in various ways and evolved through the years. Every decade the EU Action plan (2003; 2012) enshrines the path and now in 2017 we can observe the approach towards not only their rights but also obligations.

According to the European Commission Action plan (2012) there was a need for modern set of binding rules bearing in mind that soft-law rules (Bodiroga-Vukobrat, Horak, 2008; Wymeersch, 2005) in the form of recommendations have not efficiently achieved certain goals (In the Introduction of the Action Plan, the fields of "say on pay" and more sustainable companies are accentuated). But on the other hand, it must be borne in mind that mandatory rules can reduce the focus on the substance of good governance and they can remove the key responsibility of boards and shareholders for the quality of corporate governance and reduce the governance to the compliance debate with the regulators. Formalistic "comply or explain" (Horak and Bodiroga Vukobrat, 2011; Seidl and Sanderson, 2009) approach leads to a legalistic board approach with no in-depth board discussion on the governance of firm but with lawyers and auditors that have to fulfil the necessary formalities (EcoDa "Comply or explain" Preserving governance flexibility with quality explanations, Report, 2012). Corporate governance has helped in last decade to redefine the powers within the corporation (such as role of the shareholders and board). It is important that shareholders have the right to a fair return in addition to full and fair information through transparent accounts (Vincke and Heimann, 2003). Accordingly, the shareholders are given more information and possibilities to oversee remuneration policy and related party transactions and their cooperation is made easier that way (Action Plan, 2012). One of the most important challenges of the Action Plan was and still is the engagement of shareholders (Hopt, 2015). At the moment, we can only

theoretically elaborate the solutions of newly adopted Shareholders' Rights Directive (not yet published in the Official Journal, available at:
http://data.consilium.europa.eu/doc/document/PE-2-2017-INIT/en/pdf) and practical issues will be seen only after implementation in practice.
Since overall quality of corporate reporting has gone up and the focus now should be on more improvement in the general quality of disclosure around corporate governance (Commission Recommendation on the quality of corporate governance reporting ”comply or explain“, 2014/208/EU, L109/43) and a clear articulation by each company of how its governance arrangement support its business model. The assumption that shareholders (Horak and Dumančić, 2011) are the monitors of companies´ governance presupposes their engagement. It must cover better oversight of remuneration policy, which is at this moment one of the hottest topics in the EU Member States.
An oversight of related party transactions, regulating proxy advisor, clarification of the concept of “acting in concert” and employee share ownership, all this has been more or less regulated by the “old” Shareholders’ Directive (Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies) but since 2007 the implementations in practice have not shown any special improvement, particularly in new Member States such as Slovenia, Bulgaria, Romania, Croatia (See figures in Tipurić, 2015).
The analysis in other Member States shows different approaches in implementation (Hopt, 2015) bearing in mind 28 /future 27/ different national company laws and different solutions within.
As concerning the transparency, it is also important to mention the strengthening of disclosure of board policies, diversity and non-financial risk management, quality of explanations for non-compliance in corporate governance reports, shareholders´ identification and transparency of voting policies.
The focus moved from purely shareholder approach to more stakeholder approach. Furthermore, as we can see from newly adopted SRD, after financial crisis there has been a need to improve transparency and disclosure of shareholders data. Beside the stakeholder approach, we can also see more social elements or attempt to ex ante put some obligations on shareholders and company management. Issue and regulation of say on pay can be an example of how shareholders’ rights can be foreseen as a public socioeconomic phenomenon despite their private law origin, principles of freedom to contract or private autonomy (Wagner and Wenk, 2017).

2. IMPLEMENTATION IN MEMBER STATES

The objectives and goals of the EU company law have been achieved and facilitated in the first place by the freedom of establishment and free movement of capital (Horak and Dumančić, 2016; Horak, Dumančić, Poljanec, 2015) among other fundamental freedoms. According to the Andenas, Gűtt and Pannier, it has potentially very important role for company law: almost every national regulation concerning companies is likely to restrict or to affect the establishment and movement of companies (Andenas, Gűtt, Pannier, 2005).
It affects not only the setting up of companies but also the statutory aspects and management of the companies. The secondary sources of the EU Company Law are few regulations regulating supranational forms of companies and number of directives.
Since directives do not have direct horizontal effects (Andenas, Gűtt, Pannier, 2005), the effect of the EU law weakens in the area of company law between the Member States. The addressees of the directives are Member States and individuals cannot refer to them in their relations with other individuals. The national law provisions referring to the company, which are contrary to the directives, have the effect considering individuals’ subjective rights until

this national standard is annulled by the national legislator, even though, the European Court of Justice determined in the meantime that the national standard was contrary to the directive (Horak, Dumančić, 2015). According to the European Court interpretations, national courts are obliged to interpret national law in a way and light of the expression and objective of the directive in order to achieve results determined by the directive. These requests in practice actually achieved a direct horizontal effect (Case C-106/89 Marleasing SA v La Comercial Internacional de Alimentación SA, ECLI:EU:C:1990:395).

In accordance with the principle of subsidiarity and by interpreting the notion of directive, Member States are given the right to choose the way of objective implementation determined by the directive. In this respect, within the Member States company laws we can use term convergence instead of term harmonisation because the differences in implementation show that Member States are achieving goals of the directives in different ways; not only to achieve "attractive" company law /regulatory competition, which would also attract investors, but also to deter different national regulatory solutions.

3. STATE OF PLAY – SRD SOLUTIONS

Besides the constant strengthening of the shareholders' rights on the EU level, there is a reasonable concern coming from the fact that the enlargement of their rights lowers their activity. The Study on monitoring and enforcement practices in Corporate Governance in the Member States (Risk Metrics Group, 2009) shows that large number of shareholders in EU are passive investors and small number of them are using their rights. The Study refers to them as "absentee landlords". Controlling shareholders use different techniques to raise their influence in company during the decision making process against the interest of the company and especially against the interest and influence of institutional investors. Companies and their management board are not always capable to control certain shareholders' rights referring in first place to the controlling shareholders (Van der Elst, 2010). Investors' confidence that the capital they provide will be protected from misuse or misappropriation by corporate managers, board members or controlling shareholders is an important factor in the development and proper functioning of capital markets (G20/OECD Principles of Corporate Governance, 2015).

Of course, the shareholder engagement is not purely the voting rights, it is much more. It is a full purpose dialogue /so called stewardship/ on strategy, performance risk, capital structure, corporate governance, say on pay which aim is to promote a long-term success of companies (EcoDa and IFC: A Guide to Corporate Governance Practice in the European Union, ecoDa and IFC).

As explained in the Preamble of the Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, the financial crisis has revealed that shareholders in many cases supported managers' excessive short-term risk taking, so the objective of revised directive is to redress the situation and contribute to sustainability of the companies. There are new requirements to support and enforce long-term engagement and transparency. New requirements are in the field of remuneration of directors introducing the "say on pay". That means that shareholders will have right and obligation to vote on remuneration policy of the directors. Furthermore, the remuneration policy must be linked to the long-term objectives taking into account among other issues the overall situation within the company and employees payments. That means also using financial and non-financial performance criteria like environmental, social and governance factors. The novelty is also a public disclosure of the remuneration policy immediately after shareholder voting at the general meeting (Inserted Articles 9a, 9b, p. 53-60). Furthermore, requirements apply to identification of shareholders (Inserted Chapter Ia, Article 3a Identification of shareholders). According to the new rules, the Member States will

ensure that companies have right to identify their shareholders and to obtain information regarding their identity from any intermediary in the chain that holds the information. There is a limitation regarding the percentage which means that Member States may provide for companies having a registered office on their territory to be only allowed to request the identification of shareholders holding more than a certain percentage of shares or voting rights. Such a percentage shall not exceed 0.5 %. There are obligations on intermediaries regarding the facilitation of the shareholders' rights, including the right to participate and vote at the general meeting. They have also obligation to deliver to the shareholders all information from the company that will enable appropriate exercise of their rights. All this must be done in standardised and timely manner. Any charges that would occur in relation with all the procedure must be publicly disclosed (Article 3b, c, d, e, f). Regulating transparency of institutional investors, asset managers and proxy advisors will help them to be more transparent in line with shareholders engagement. There is an obligation to develop and publicly disclose the shareholders engagement policy. The aim of the policy is to describe how shareholders engagement is integrated in their investment strategy, how they manage a potential conflict of interest. If they do not develop the policy, they must explain their choice (Articles 3g, h, i, j, k). Services of proxy advisors are also regulated bearing in mind their influence on investors voting behaviour. Within the new requirements of SRD proxy advisors will be subject to the code of conduct and transparency requirements. Regarding the related party transactions, new SRD provisions regulate that material related party transaction goes for approval by the management or supervisory body. The companies are obliged to publicly disclose transaction at the time when transaction is concluded at the latest with all needed information to access the fairness of transaction. All the information must be collected, processed and transmitted in line with Regulation (EU) 2016/679 of the European Parliament and of the Council of 27.4.2016 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, OJ L 119, 4.5.2016) which is also relatively new and demanding regulation.

4. CONCLUSION

There are lots of issues and requirements addressed by the new SRD in order to encourage a long-term shareholders engagement and increase transparency. Is it possible in business practice to turn the absentee landlords into engaged shareholders on Internal Market with this new requirements?

The Shareholders´ Rights Directive contains provisions on shareholders rights to vote on remuneration policy, identification of shareholders and facilitation of exercise of shareholders rights. Can we foresee that obligatory voting affects the obligatory decision of supervisory bodies?

The SRD provides rules that foster transmission of information, transparency for institutional investors, asset managers, proxy advisors and related party transactions.

The Member States will have up to two years to incorporate the new provisions into national law. The SRD recognizes different models of corporate governance which is a step forward in regulating such important issues. One of the main questions is the power of directive as a legal instrument in enforcing shareholders rights in future 27 different national company laws of the Member States. As always when new regulatory framework is introduced, only application and enforcement in the practice in due time will give the right answers.

LITERATURE:

1. Andenas, M, Gűtt, T, Pannier, M. (2005). *Free Movement of capital and National Company Law,* 16 Eur.Bus.L.Rev 757. Retrieved 09.05.2017. from http:// heinonline.org.

2. Bodiroga Vukobrat, N, Horak, H. (2008). Kodeksi korporativnog upravljanja-instrument socijalno odgovornog gospodarenja. In N. Bodiroga-Vukobrat, S. Barić (ed.), *Socijalno odgovorno gospodarenje*. Zagreb: Tim press i Pravni fakultet Sveučilišta u Rijeci.
3. Case C-106/89 Marleasing SA v La Comercial Internacional de Alimentación SA, ECLI:EU:C:1990:395
4. Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies. OJ L 184, 14.7.2007.
5. Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement,
6. EcoDa (2012). *„Comply or explain" Preserving governance flexibility with quality explanations, Report.* Retrieved 02.05.2017. from http://www.ecoda.org/docs%20-%20OK/Conferences/2012_03_27%20Comply%20or%20Explain/2012AnnualConf-ecoDa-CoEreport.pdf.
7. EcoDa and IFC (2015). A Guide to Corporate Governance Practice in the European Union. Retrieved 02.05.2017. from www.ifc.org/corporategovernance.
8. European Commission (2012). Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM (2012) 740/2. Retrieved 20.04.2017. from www.ec.europa.eu .
9. European Commission (2014). 2014/208/EU: Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain') Text with EEA relevance. OJ L 109, 12.4.2014.
10. European Commission (2014). Press Release: European Commission proposes to strengthen shareholder engagement and introduce a "say on pay" for Europe's largest companies (April 9). Retrieved 05.05.2017. at www.ec.europa.eu
11. European Parliament and European Council: Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement. Brussels, 23 March 2017 (OR. en). PE-CONS 2/17.
12. Hopt, J. K. (2015). Corporate Governance in Europe A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance. *Law Working paper No 296/2015*. Retrieved 03.04.2017. from www.ecgi.org/wp.
13. Horak, H, Bodiroga-Vukobrat, N. (2011). EU Member States´ Experiences with the „Comply or explain" Principle in Corporate Governance. *Croatian Yearbook of European Law and Policy*, Vol. 7, Zagreb: Faculty of Law University of Zagreb.
14. Horak, H, Dumančić, K, Poljanec K. (2015). *EU Market Law*. Zagreb: Faculty of economics and business.
15. Horak, H, Dumančić, K. (2011). Jačanje prava dioničara i pravo dioničara na informacije. *Pravni vjesnik*. Godina 27, No. 3-4. Osijek: Faculty of Law University of Osijek.
16. Horak, H, Dumančić, K. (2016). Freedom of establishment: VALE Case – Direction for New Rules: Dreams or Reality? in N. Bodiroga Vukobrat, S. Rodin, G. G. Sander (eds.) *New Europe – Old Values*. Switzerland: Springer.
17. Horak, H, Dumančić,K. (2015). Harmonisation of the croatian Company Law with Aquis Communitaire of the European Union. In *Croatian &Company Law Proceedings*. Zagreb: Fauculty of economics and business University of Zagreb. Retrieved 09.05.2017. from http://web.efzg.hr/dok/pra/hrvatsko_i_europsko_pravo_drutava_2.pdf
18. OECD (2015). G20/OECD Principles of Corporate Governance. Paris: OECD. Retrieved 09.05.2017. from http://dx.doi.org/10.1787/9789264236882-en.
19. 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) OJ L 119, 4.5.2016.

20. RiskMetrics Group (2009). Study on monitoring and enforcement practices in Corporate Governance in the Member States. Retrieved 08.05.2017. from http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf
21. Seidl, D, Sanderson, P. (2009). *Applying „Comply or explain": conformance with codes of corporate governance in the UK and Germany*. Centre for Business Research, University of Cambridge Working Paper No. 389. Cambridge: University of Cambridge. Retrieved 10.05.2017. from http://www.cbr.cam.ac.uk/pdf/WP389.pdf.
22. Tipurić, D. et al. (2015). *Korporativno upravljanje u Hrvatskoj - Ocjena kvalitete korporativnog upravljanja hrvatskih dioničkih društava SEECGAN metodologijom*. Zagreb: CIRU.
23. Van der Elst, C. (2010). *Law and Economics of Shareholders Rights and Ownership structures: How trivial are Shareholder Rights for Shareholders*. TILEC Research Paper No. 008/2010. Tilburg: Tilburg Law School. Retrieved 08.05.2017. from http://ssrn.com/abstract=1553094 .
24. Vincke, F, Heimann, F. (ed.) (2003). *Fighting corruption A Corporate Practices Manual*. Paris: ICC.
25. Wagner, F A, Wenk, C. (2017). *Agency versus Hold-up: Benefits and Costs of Shareholder Rights*. Finance Working Paper No. 500/2017. Retrieved 10.05.2017. from www.ecgi.org/wp.
26. Wymeersch, E. (2005). Implementation of the Corporate governance Codes. In K. Hopt, E. Wymeersch, H. Kanda, H. Baum, H. (ed.). *Corporate Governance in Context: Corporations, States and Markets in Europe, Japan and the US*. Oxford: Oxford University Press.

THE IMPORTANCE OF PERFORMANCE MANAGEMENT SYSTEMS IN PUBLIC HEALTHCARE

Sandra Raquel Alves
CIC.DIGITAL; Polytechnic Institute of Leiria; ESTGF, Polytechnic of Porto, Portugal
raquel.alves.pt@gmail.com

Rui Vieira
IESE Business School, Madrid, Spain; University of Amsterdam, Netherlands
rjovieira@gmail.com

Humberto Ribeiro
GOVCOPP; ESTGA, University of Aveiro, Portugal
humberto@alumni.dmu.ac.uk

ABSTRACT

The modern societies continue to face significant challenges and dilemmas. On the one hand, competition and the need to care about the resources employed. On the other, a society increasingly demanding on a better quality of life, which includes longer longevity and more health care services – preferably of better quality as well. Scientific and technologic advances on healthcare continue to shape our way of living, but they also pose issues for governments and organizations, as health expenditures continue to increase, apparently without any limit in sight. It is within this scope that this paper deals with the need to research on the performance measurement and management systems in healthcare. For this purpose, and also because there is a gap in the literature, this paper examines the changes in the hospital management, highlighting the specific characteristics of the healthcare sector that make it so different from all other economic sectors, due to their access level and its importance for the users, regardless of their financial situation. Accordingly, this paper employs a qualitative approach, used to develop an analysis of the Portuguese public healthcare sector. Using a framework developed by Ferreira & Otley (2009), twelve dimensions are examined, while being applied to a Portuguese public hospital. Despite the limitations of the research, it was made clear that the healthcare sector is facing significant changes in Portugal, which is following some international trends. The increasing incorporation of private-managerial type on the public sector, led to many changes in public healthcare in Portugal, although several problems that surged in terms of benchmarking, being the lack of enough financing a major caveat.

Keywords: *Case Study; Healthcare, Management Systems; Performance Evaluation, Public Hospital*

1. INTRODUCTION

The modern societies continue to face significant challenges and dilemmas. On the one hand, competition and the need to care about the resources employed. On the other, a society increasingly demanding on a better quality of life, which includes longer longevity and more health care services – preferably of better quality as well. Scientific and technologic advances on healthcare continue to shape our way of living, but they also pose issues for governments and organizations, as health expenditures continue to increase, apparently without any limit in sight. It is within this scope that this paper deals with the need to research on the performance measurement and management systems in healthcare. For this purpose, and also because there is a gap in the literature, this paper examines the changes in the hospital management, highlighting the specific characteristics of the healthcare sector that make it so different from

all other economic sectors, due to their access level and its importance for the users, regardless of their financial situation.

Accordingly, this paper employs a qualitative approach, used to develop an analysis of the Portuguese public healthcare sector. Using a framework developed by Ferreira & Otley (2009), twelve dimensions are examined, while being applied to a Portuguese public hospital.

Despite the limitations of the research, it was made clear that the healthcare sector is facing significant changes in Portugal, which is following some international trends. The increasing incorporation of private-managerial type on the public sector, led to many changes in public healthcare in Portugal, although several problems that surged in terms of benchmarking, being the lack of enough financing a major caveat.

In terms of contents, after a discussion on the increasing importance of management and control in public healthcare, this paper presents the methodology and the theoretical framework that has been used in the case study, which was applied to a public hospital organization in Portugal, followed by a global discussion of the evidence collected.

2. THE INCREASING MANAGEMENT AND CONTROL ROLE IN PUBLIC HEALTHCARE

The increasing incorporation of private-managerial type on the public sector, is leading to many changes also in public healthcare in Portugal, which include legal transformation in public hospitals, among other juridical changes and governing experiments. However, several problems arose in terms of benchmarking. For example, when applying some management based on the Tableau de Bord, there is an absence of a reference for each indicator; or a real commitment of administrators and managers to achieve the goals of the hospital; and, finally, a lack of trust in hospitals.

There is a tendency to provide practitioners who in hospitals play a major role in the consumption of resources, for example doctors and nurses, the more rigorous cost information, in particular at the level of each procedure, in order to raise awareness of the Their activities (Hill, 2000). However, there is still a long and winding road to travel for cost information to be legitimized in medical decisions (Kurunmaki et al., 2003; Nyland and Pettersen, 2004).

With respect to the Balanced Scorecard (BSC), Kaplan and Norton (1996) have revolutionized the world of management with its introduction, arguing that this appears as a complement to the traditional management indicators, being a strategic management system based on four perspectives: financial, clients, processes and learning and development. The Balanced Scorecard deals primarily with performance indicators and is reviewed in other performance evaluation models. The Tableau de Bord in the mid-20th century and the Balanced Scorecard of the 1990s have a common starting point: to question the preponderance of financial indicators in performance evaluation (Mendoza and Zrihen, 1997).

On the other hand, there are several studies that point to the Activity Based Costing (ABC) method as the appropriate system to determine the costs of hospital activities, through the inducers of resources and to determine the costs of services through the inducers of activities. Thus, the ABC method can help in fulfilling functions such as planning and control, in particular, regarding the relevance of operating cost accounting (Lanchmann, 2007).

This method may be adequate in linking medical and financial decisions in order to improve performance, obtaining better care with greater resource efficiency (Ross, 2004). Also the use of econometric models to mitigate the high costs of medical labor is suggested (eg Peden and Baker, 2002).

Changes in the health sector (Lapsley, 1998, 1999) and the role of accounting in change (see eg Bourn and Ezzamel, 1986, Broadbent and Guthrie, 1992, Abernethy 1996, Goddard 1997,

Jacobs 1998, Doolin 1999) have attracted attention and their effects studied (Chua and Preston, 1994; Lapsley, 1999). Issues related to the relationship between information systems and changes in management accounting have "explored the concept of change" (Quattrone and Hopper, 2001), however, critics of reforms in this sector argue that increases in funding did not lead to a comparable increase in performance (eg Mayle et al., 2002; Modell, 2004; Agrizzi, 2008) and government responses to this criticism have been overvalued. The use of accounting and cost information, when articulated with the transposition of cost accounting systems from the private sector to the public sector, is recognized in the literature as problematic, especially in hospitals (Llewellyn and Stewart 1993, Evans and Bellamy, 1995, Skaerbaek and Thisted, 2004).

Abernethy and Lillis (2001) carried out a study in which the objective was to develop and analyze empirically the interdependencies between strategy, internal management of structures and the evaluation of performance systems, collecting data for this purpose, from clinical units of Large public education hospitals in Australia, and stressing that the sample has sufficient diversity of strategic guidelines and performance appraisals. At the time of the study the hospitals had been subject to reforms based on reforms designed to encourage and implement systems to improve efficiency. One of the changes considered fundamental, as part of these reforms, was the introduction of possible financing, generally known as Diagnosis Related Grouping (DRG).

The existing literature identifies a consensus in management and accounting: it states that organizational survival is dependent on an adjustment between the organization's strategy and the structure and process management (Miles and Snow, 1992, Fisher 1998, Abernethy and Lillis, 2001). Thus, a successful organization is one that implements management structures and processes that facilitate the realization of its strategic choices and in turn the unsuccessful one has "poor" adjustments (Abernethy and Lillis, 2001).

Also in the health sector, Agrizzi (2008) elaborated a study, but its objective was to understand how the processes introduced by the English Government have been redefined in the health systems, pointing out as a basis for their realization the broad implications of these policies and the fact that have not been sufficiently investigated in the organizational context by the accounting literature.

3. RESEARCH METHODOLOGY

The adoption of a research framework followed the consideration of some methodological guidelines adopted in the light of conclusions obtained from a preliminary inquiry that helped to clarify some aspects of interest to examine, according to experts on the field, with responsibilities in the healthcare sector. For this purpose, it is more noteworthy to mention that an interview was previously held to a responsible for the administration of a public hospital organization, namely its chief financial officer (CFO), which allowed a better understanding of some unclear aspects, as well as to deepen the knowledge of the hospital sector in Portugal.

Following the definition of the topics with potential interest to the investigation, the methodology of analysis was then oriented to such topics' examination, ending with the selection and the adjustment of a specific framework that was employed for the empirical research, consisting of a case study carried with a Portuguese Public Hospital.

Subsequently to an examination of the literature, we adopted the selection of the variables made by Ferreira & Otley (2009), who developed a framework focused on the detailed analysis of the design and use of performance management systems. This framework fits not only on the theoretical design of the research developed here, as it also allows clarifying and deepening some research aspects.

However, the framework developed by Ferreira & Otley (2009) contains some challenges of adjustment, due to the complexity of the framework itself, and due to the complex nature of the healthcare sector. Nonetheless, the framework do also provides the advantage of simplicity in application. It is a framework that is based mainly in twelve pillars of analysis, which are presented below, adapted to the purposes of this research, and particularly to hospital organizations: i) vision, mission and objectives; ii) key factors for success; iii) organizational structure; iv) strategies and plans; v) key measures of organizational performance; vi) setting goals; vii) performance evaluation; viii) reward systems; ix) information flows, systems and networks; x) use of systems management / performance measurement (PMSs); xi) changes in management systems / performance measurement (PMSs); and xii) consistency and robustness of the components of management / performance measurement (PMSs) systems. To help to understand how these twelve dimensions interact, Figure 1 is shown below.

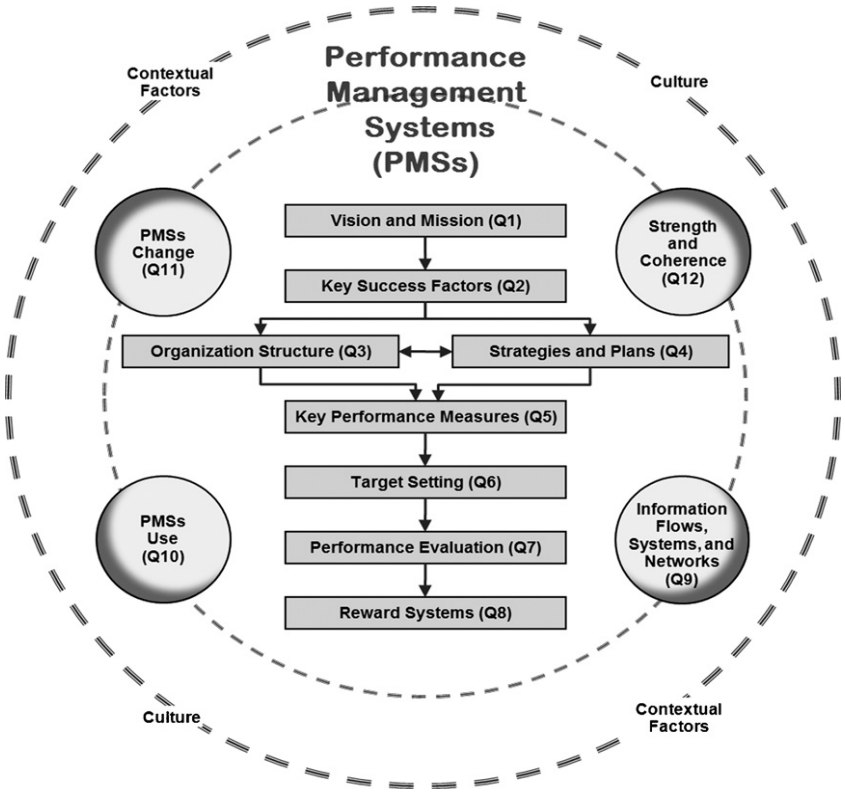


Figure 1: Framework of performance management and measurement systems

It is important to note that it was necessary to make some adjustments in order to better fit the framework to the research goals. One factor of adjustment to the framework designed by Ferreira & Otley (2009), consisted in adding some dimensions such as innovation, autonomy or training. Given the cumulative and combined complexity of Ferreira & Otley framework's, derived also from the use of other literature, it was decided to integrate some of the dimensions in the dimensional macro-assumptions proposed by the aforementioned authors. A more detailed presentation of each of the dimensions is given later in this paper, together with our examination made with the case study.

4. THE PUBLIC HOSPITAL IN FOCUS

In this section of the paper, we proceed with the development of the case study itself, starting with the presentation of the public hospital organization targeted by the case study, here

designated as “Public Hospital”, as for reasons of confidentiality, it is not possible to make publicly available very much detailed information about the organization, which could consequently compromise the confidentiality previously agreed with the respondents who accepted to collaborate with this research.

4.1. Description of the organization

Despite the confidentiality agreement, it can be mentioned that the Public Hospital is a hospital unit that came into operation in the 1990's and currently covers a population of about 400,000 inhabitants in the Centre region of Portugal. Being a reference hospital unit, it develops its assistance activity in hospitalization, having an average of 450 beds. In statutory terms, is has been transformed, in accordance with Decree - Law no. 233/2005, into a Public Business Entity. This hospital organization covers a wide range of areas such as Pathology, Anesthesiology, Cardiology, General Surgery, Dermatology, Stomatology, Physical Medicine and Rehabilitation, Gastroenterology, Gynecology, Hematology, Radiology, Immunohemotherapy, Internal Medicine, Intensive Care, Neurology, Neurosurgery, Obstetrics, Ophthalmology, Medical Oncology, Orthopedics, Otorhinolaryngology, Clinical Pathology, Pediatrics, Pedopsychiatry, Pulmonology, Psychiatry, Hemodynamic and Cardiac Pacing Unit, Cardiac Intensive Care Unit and Urology Service.

The Public Hospital tries to promote equality of the sex’s policy, both while hiring human resources and with remuneration policies. It should also be noted that the organization in question has been actively collaborating with several higher education institutions in nursing, pharmacy, social work, information technology, diagnostic and therapeutic technicians, among others, in addition to receiving a significant number of physicians for regular year attendance or specialty training.

The Public Hospital has a global accreditation process underway, which has resulted in the adoption of multiple policies and procedures aimed at improving quality and safety at the level of structures and resources, processes and results at all organizational levels. The hospital has an approved and valid Code of Ethics, which aims to reinforce the internal affirmation of a set of values, principles, duties and standards of conduct to be observed by all employees, particularly in relation to patients.

All professional groups are obliged to respect the duties of confidentiality, professional secrecy and loyalty, and must comply with the rules of professional ethics laid down for the respective groups.

4.2. Participants in the case study

With regard to the participants in the case study of the Public Hospital, and their profiles, five contributions were obtained: two members of the administration and three professionals from the organization, being a nurse and two doctors, only one of whom is specialist.

More specifically, there were interviewed at the Public Hospital: an executive vowel in office for one year ago, but earlier in exercise of the functions of Executive Director, which may therefore be referred as Administrator. The administrator has a graduate in Law and a postgraduate degree in Hospital Administration from the National School of Public Health.

As for another member of the administration, he is the Chief Financial Officer, a collaborator in the hospital for more than 29 years, has a degree in Economics and is a lecturer at a School of Health, in which he teaches several curricular units, namely Health Management.

The remaining interviewees, who do not carry out administrative functions, include: a nurse, who is naturally graduated in nursing and who has worked in the hospital for more than 25 years. She has never worked in the private sector. A Physician Specialist in surgery who works in the institution for more than 20 years. And, finally, another general practitioner, who can be referred simply as a Physician, who has been working in this hospital for about a

year, with the safeguard that when she terminates her contract she will be expected to work for a hospital in Germany, in Berlin, where she is offered substantially better remuneration conditions, namely a salary increase four to five times higher than what she currently enjoys in Portugal.

5. A PUBLIC HOSPITAL CASE STUDY

In this section it is presented the set of evidence obtained for the twelve dimensions that make up the framework of analysis adopted for the analysis of the case study. The analysis for each dimension of analysis dimension comprises an initial theoretical introduction, followed by a box with a resume of evidence gathered, and final comments and conclusions

5.1 Vision, Mission and Objectives

Regarding the first of the twelve pillars of analysis, it is noted that Ferreira & Otley (2009), refer just generally, as "vision and mission", having also added organizational "objectives", possibly to identify an organization explicit guidance for obtaining organizational results. This addition appears consistent with the reflection of the authors, who reported on several occasions to the thematic objectives, supporting their use in literature, such as Otley & Berry, (1980), which recalled that there are objective since there long been considered critical to the control being used to assess performance; and Chenhall, (2003) who note that organizations are naturally forced to have to achieve multiple objectives; or Otley (2008),who pointed out that the objectives are typically defined by top management in order to meet the expectations of shareholders, or the state itself.

Vision: construction of a reference hospital, from the point of view of the quality of the health care provided and with the concern to obtain the recognition of the community, in order to obtain a high satisfaction of the patients and professionals.

Mission: to provide differentiated healthcare, in conjunction with primary health care and other hospitals integrated in the SNS network (“Sistema Nacional de Saúde”, Portugal’s equivalent to UK’s NHS – “National Health Service”).

In terms of evidence and generic conclusions for this first dimension of analysis of the case study for the Public Hospital, it was verified that the concepts of vision and mission are institutionally defined, being publicly disclosed on the hospital website and / or official documents, such as reports and accounts or plans of activities and budgets, but there is no in-depth knowledge on the part of health professionals. As for the objectives, there is knowledge within the institution, although its transmission is more informal. However, it should be noted that there are mechanisms for the transmission of organizational purposes, both informally and formally, as in the case of an important vehicle for the dissemination of information, the intranet, although it seems that the degree of consultation on the part of the professionals can be somewhat limited.

5.2 Key Success Factors

Continuing to follow Ferreira & Otley (2009), with the second dimension, the key factors for success, we intend to investigate the factors considered key to successfully achieving the overall success of the future hospital and try to understand how they are transmitted from the management to the employees, from doctors, to nurses, and other technical experts.

In short, there seems to be some lack of definition as to the key factors for success, which thus have not been clearly communicated to employees. The five factors mentioned as critical to the future global success of the hospital: knowledge, common sense, consensus striving, motivation, and work seem more intuitive than properly reflective and embedded in a particular planning or programming. Existing conditions also appear to act as a constraint,

notably resource constraints, as well as the lack of organization reported by some contributors, although it has been found that a number of improvements have been made recently. The size of the Public Hospital in analysis is added, which, although not colossal, is not reduced either, reason why it poses additional challenges of coordination and management, leading to the primacy of current management. Finally, its transmission seems to be "closed" to employees without administrative functions, and there are also some contradictions in this matter.
For example, while referring to the existence of information, it is also recognized that there is no plan for its transmission.

5.3 Organizational Structure

Regarding the organizational structure, it seeks to understand in the first place, if it is formalized and what type it is. It then goes on to attempt to understand if the organizational structure itself influenced somehow the design and mode of use of management / performance measurement (PMSs) systems as well as understand whether these systems can include both measurement Resource Management Performance as a Clinical Management Performance (ie RMP and CMP). Sequentially intends to inquire into the possible existence of RMP can contribute, or have contributed to the achievement of organizational outcomes via efficiency. Finally, we seek to know how is the organizational structure that interacts with the process of strategic management, ie, we try to understand how organizational structure influences and how it is influenced by the strategic management process.
In terms of an overall assessment of this dimension, it can be concluded that the organizational structure of the Public Hospital in question is of the horizontal type. In fact, although admittedly "complex" and "very large", the structure was assumed by respondents to be "flat", i.e. with reduced hierarchical cleavage. Apparently the structure is balanced, with the implicit recognition that the type of structure in force influences its own design. The administration includes a doctor, a nurse and an administrator. The clinical director provides guidance to physicians and a nurse director, gives guidance to nurses. There are three groups of formal services: care services; care support services; and management and logistics services. At the same time, there is a multiplicity of committees, which are more informal, given that they are formal structures but with an informal mode of functioning.
Concerning the relevance of performance management systems to include both RMP and CMP aspects, concerns were only expressed about financial constraints, in particular on the issue of costs. Last but not least, a colleague expressed considerable reservations about her appreciation in this regard, classifying the organizational structure as a "point of fragility".
In relation to the link between the organizational structure and the dimension of the strategies and plans, whose specific analysis is presented below, it is suggested the primacy of strategic concerns with the short term, focusing more on operational than strategic issues.

5.4 Strategies and Plans

Closely related to the organizational structure, follows now the dimension of strategies and plans. We want to ascertain what the strategies of the hospital are: what types of plans have been adopted; which is the relevant time horizon. Additionally, it seeks to explore how, not only the strategies and plans are adopted, but also how they are designed and communicated to those responsible for management and employees, while examining who participates in the definition of objectives and strategic plans related. Finally, we intend to know specifically what are the processes and activities who decided to be required to try to ensure the success of the strategies.
Strategies and plans are defined by management. Transmission is made via intranet and public documents, but in a passive, informal way. Transmission only to those responsible for

the services, most of the employees revealed lack of knowledge, having asked for more information. The hospital has formal plans, i.e. annual management planning tools, as part of the performance plan. However, they are conditional on the contracting of program contracts concluded with the trusteeship. In addition to the annual economic budget, strategic plans are carried out every three years.

The concern with quality is highlighted, and the organization is completing an accreditation process. This is accompanied by the culture of efficiency, through the adoption of "sustainable attitudes", which are defined internally discussed by the services and put into practice with the aim of reducing costs while maintaining a good relationship with suppliers. The hospital seeks not only financial sustainability but also environmental sustainability, in a complementary way. Among the measures with environmental impact were: temperature control, waste control, recycling, waste treatment and reduction of energy consumption, and a cogeneration plant has recently started operating. This activity is reported in a specific chapter of the annual report. Finally, the strategic line includes investments in the improvement and modernization of facilities, with a view to obtaining a higher quality of services.

In summary, regarding the strategies and organizational plans, the "clear" concern with quality, "the provision of quality health care", and the organization is completing an accreditation process. This is accompanied by the "struggle" against "waste", trying to encourage the culture of efficiency through "sustainable attitudes", which are defined internally discussed by the services and put into practice with the aim of reducing costs, being such A practice considered an "interesting culture" by the organization itself, and maintaining a good relationship with suppliers, in order to obtain better commercial conditions. The transmission of the strategy involves the use of the intranet and public documents, therefore official, but in a passive way, reason why it can be considered of the informal type and not demonstrating the collaborators a high level of knowledge, given that the transmission is only realized in a " Active "service providers. On the contrary, the generality of the employees revealed a lack of knowledge, for example, regarding the merger processes, and demanded more information.

5.5 Key Performance Measures

At the confluence of the two dimensions previously examined, the key measures of organizational performance, which focuses on their size which in turn derive their objectives, key success factors, key strategies and action plans are now analysed. This dimension is an attempt to realize if the four BSC perspectives are present in the organization. This means to examine whether financial and non-financial indicators can be used; whether they are objective or subjective; and whether they are short or long term. Like the previous dimensions, it is also demanded to know how the measures are specified and are communicated, to whom they speak, and what role do they play in performance evaluation, trying to understand who participates and does it by their own initiative or by imposition. Finally, it seeks to evaluate whether respondents consider that there indicators or areas of performance that should be included and which have not been subject to evaluation in the organization.

The BSC is not used, although some indicators usually comprise it, such as Tableau de Bord type (as will be later verified in the dimension that addresses the PMSs).

Key measures of organizational performance are used. There is a planning system in which the objectives to be achieved are identified, as well as indicators for evaluation. Indicators are not exclusively financial, on the contrary, they are mainly indicators of a qualitative nature, integrating a system composed of non-financial, but quantifiable indicators, comprising metrics of quality, accessibility and efficiency. The financial indicators used include

production, human resources, and other economic-financial indicators. The time horizon of the indicators is short-term, usually one year.
The indicators are communicated to the service managers, being the target of internal contractual in terms of goals. There seems to be a good transmission of these to employees, especially at the level of doctors, who have shown that they are aware of the indicators that support their performance appraisals. However, although the qualitative indicators were considered as "objective" by the administration, there was no agreement on the part of the medical professionals who, in this regard, came to recognize the existence of "a lot of subjectivity", possibly resulting from the specificity of the provision type of services in the health sector. In terms of global assessment, the existence and use of key organizational performance measures is verified. It should also be noted that the Public Hospital has a planning system in which the objectives to be achieved are identified, as well as indicators for evaluation. Indicators are not exclusively financial, on the contrary, they are mainly indicators of a qualitative nature, they comprise a "system composed of non-financial indicators", which are nevertheless quantifiable, including quality, accessibility and efficiency metrics. As for the financial indicators used, they were referred to as "production, human resources" and other economic-financial indicators.

5.6 Target Setting

The sixth dimension is the definition of goals, which corresponds to assess the level of performance that the hospital needs to achieve the key performance measures, as have been identified in the previous dimension. Also specifically seeks to understand how the appropriate performance targets for key performance measures are defined, as well as trying to figure out if the targets set are easy or difficult to reach.
Overall, it is suggested that the goal-setting process is crucial for the Public Hospital, since its funding depends on compliance with those criteria, namely regarding quality and efficiency, based on an evaluation supported by financial indicators, such as contracted production; and non-financial, such as patient satisfaction, i.e. quality indicators, which relate to the perception of users. Therefore, the goals inherent to key performance measures depend on quantitative and qualitative indicators, and the management and staff are also recognized as having difficulty in achieving the proposed goals.
Likewise with what has also been mentioned in the analysis of the previous dimension, the hospital’s collaborators reiterate the subjectivity of some goals, as well as evidence of a lack of knowledge regarding the goal-setting process. This suggests contradicting the administration, which in the previous dimension had stated that the indicators used in the performance evaluation were defined in terms of goals by "internal contracting" and after "negotiation". As mentioned previously, contracting meetings are held with the service managers, where the available resources are discussed, how they are used, and the goals are defined set. However, in fact, on the part of the administration, the respondents did not express readiness to deepen this question further.

5.7 Performance Evaluation

Continuing with the framework alignment of Ferreira & Otley (2009), follows now the performance evaluation, in which they try to establish types of existing performance evaluation in the organization, if any. They also try to understand if this assessment is of participatory typology, and/or if the employees are actually involved at individual, group and/or organizational. Concurrently, there is concern to notice if performance appraisals are primarily objective, subjective, or combined, as well as how important is the formal and informal information. Finally, to check whether there are possibly existing controls over these processes.

The performance evaluation at the individual level is based on SIADAP (Portuguese evaluation system for public/governmental employees). However, the evaluation process is not comprehensive as it does not consider all categories of professionals. In addition, it continues to suffer from such "subjectivity", which has already been pointed out in the dimensions discussed before. There are also other types of evaluations, carried out outside the hospital administration, as is the case with ARS (Regional health administrations in Portugal), although more in the area of training. There are combined evaluations because in addition to individual evaluations, group assessments can also be cumulatively performed at the clinical service level. The evaluations are both quantitative, in terms of "performance" and qualitative as regards "skills". Regarding the importance of formal and informal information, it was found that management considers only "formal and rule-based" information to be important. This statement was corroborated by some contributors, who not only emphasized the fact that evaluations are essentially "objective", "number-based", but also "well communicated". However, one cannot overlook the intrinsic subjectivity, already referred to earlier, and again noticeable at the level of collaborators.
Finally, within the framework of Ferreira and Otley (2009), the existing performance evaluation seems to be participatory, at least at the implementation level, because employees not only have the possibility to discuss the evaluation individually, but are also invited to present their “assessments, difficulties, and objectives".

5.8 Reward Systems

Reward systems’ corresponds to the eighth central dimension of the framework adopted. Here it is intended to determine which financial and/or non-financial incentives will earn those responsible for management and employees for achieving performance targets, or other aspects of performance considered, as well as trying to find out if there are penalties for those who do not achieve a certain level of goals proposals.
In short, there are no reward systems in the Public Hospital, being this view transversal to all the interviewees who, in turn, made a point of demonstrating their discontent and their lack of motivation, nevertheless having the awareness that to a great extent such is due to the current economic situation. On the other hand, however, as for possible penalties, they do not exist either, reinforcing the idea that this is a matter of mere bureaucracy and a basically irrelevant in practical terms.

5.9 Information Flows, Systems and Networks

This is the first of four dimensions of the environment of the framework adopted (vid. Figure 1). The first of these are the flows of information, systems and networks, which represent specific information flows, feedback (feedback) and feedforward (post-return), as well as the networks and systems in place that support the organization and operations of their management systems/performance measurement.
It was possible to detect the existence of several flows and information systems. However, it is felt that its use and utilization is very limited, in line with what standard information systems currently offer to most organizations.

5.10 Performance Management Systems (PMSs) Use

The tenth dimension is the use of management/performance measurement, which focuses on the type of use made of information and the various mechanisms established to control/manage control systems. This dimension of analysis includes a curious aspect, which is to try to determine whether such uses can be associated with certain types and kinds of uses that respondents may have had knowledge through literature, in reports, or other technical documents. Additionally, it also focuses on how the controls and their uses may possibly

differ according to different hierarchical levels. One component to examine specifically is whether a strategic emphasis on innovation, and/or implementation of information and control systems, encourages the effective use of budgetary control systems, as well as whether such effective use can contribute to obtain added organizational outcomes.
There is an actual use of information and various control mechanisms, which can be considered up to the level of management control systems. Its use suggests to be mainly of the diagnostic type (Simons, 1995), given the limited interpretation, as demonstrated by the collaborators.
Moreover, in this dimension of analysis, the transmission of information to employees is merely passive, so it does not seem to be working properly. Nonetheless, its possible contribution to obtaining possible organizational results was confirmed.

5.11 Performance Management Systems (PMSs) Change

Changes in management/performance measurement systems correspond to the penultimate dimension, seeking here trying to understand how the PMSs have changed in light of the dynamics of change of the hospital and its surroundings, as well as whether these possible changes in design or use of PMSs were conducted in a proactive or reactive manner.
There seems to be a genuine concern about monitoring the change processes, not least because it was possible to determine the existence of an attitude not only reactive but also proactive. Reactive attitude in relation to decisions of guardianship, legal decisions, regulations, among others; and proactive while using a set of indicators (from management systems), so that certain undesirable events can be avoided.

5.12 Strength and Coherence

Finally, the last dimension of the framework of Ferreira & Otley (2009), focuses on the consistency and robustness of the components of management/performance measurement systems, trying to understand the links that may exist between the components of the PMSs and possible ways in which they can be used, following the eleven dimensions discussed earlier. Also seeks to capture the possible concern of the hospital to adopt innovative approaches and to perceive any innovative action that could have been adopted. This last dimension concludes with the concern of trying to understand the existence of a policy of targeted bonuses for efficiency gains which may result in achieving organizational results, as well as the existence of a policy of targeted training human resources for efficiency gains that may result in the achievement of organizational outcomes.
The concern to maintain an innovative attitude, adjusted to change, both using reactive and proactive approaches, is confirmed. Respondents considered that adopting an innovative attitude could actually justify the adoption of incentive policies. They also considered that the existence of a bonuses policy aimed at efficiency gains could result in the achievement of organizational results. They also highlighted the advantages inherent to the possibility that professionals could eventually dedicate themselves exclusively to the public hospital activity.
However, with regard to the possibility that an innovative attitude could justify the existence of incentives for the training of human resources, the situation remains unclear. If it is true that the Chief Financial Officer agrees, it is no less true that other employees disagree, as they are faced with a hospital which is at least moderately innovative but which, however, offers very few conditions to improve the training of its employees.

6. CONCLUSION

The Public Hospital presents strategies and plans, key organizational performance measures and a performance evaluation system that can be considered of a high standard. However, this guiding line ends up leading to almost nothing, when it comes against the total absence of a

reward system. Indeed, while operating with reasonable levels of efficiency and effectiveness, however, despite these efforts, one can conclude that the organization potential is highly subdued, since the personal is not motivated by the non-functioning evaluation system, seen as mere bureaucratic process.

Nonetheless, the case study develop allowed to capture the importance given to values, not just the vision, mission, and objectives. The intrinsic human nature of hospital activity makes it so unique. Thus, it seems interesting to be able to focus an investigation on the role and importance of human health and values, together with the delicate interactions with normally inhuman organizational requirements in terms of results, such as effectiveness in increasing demand and, especially efficiency. Another important contribution of this paper relates to its originality, allowing to mitigate the gap that exists in the literature in Portugal. It also corroborates and connects to existing literature. For example, the research made allowed to observe that the application of Ferreira & Otley (2009) framework's is highly conditioned by the absence of a more developed system for assessing and rewarding performance, thus limiting the analysis a number of other dimensions, such as setting goals and systems management/performance measurement. In fact, PMSs are very limited in the organization.

Despite the limitations of the research, it was made clear that the healthcare sector is facing significant changes in Portugal, which is following some international trends. The increasing incorporation of private-managerial type on the public sector, led to many changes in public healthcare in Portugal, although several problems that surged in terms of benchmarking, being the lack of enough financing a major caveat.

ACKNOWLEDGEMENT: *This work was financially supported by the research unit on Governance, Competitiveness and Public Policy (project POCI-01-0145-FEDER-006939), funded by FEDER funds through COMPETE2020 - Programa Operacional Competitividade & Internacionalização (POCI) – and by national funds through FCT - Fundação para a Ciência & a Tecnologia.*

LITERATURE:

1. Abernethy, M. A. & A. M. Lillis, (1995), "The impact of manufacturing flexibility on management control system design", *Accounting, Organizations and Society*, Vol. 20 (May), pp. 241-258.
2. Abernethy, M. A. & A. M. Lillis, (2001), "Interdependencies in organization design: a test in hospitals", Journal of Management Accounting Research, Vol. 13, pp. 107-225.
3. Abernethy, M. A. & W. F. Chua, (1996), "A field study of control system "redesign": the impact of institutional processes on strategic choice", *Contemporary Accounting Research*, Vol. 13, pp. 596-606.
4. Abernethy, M. A., (1996), "Physician and resource management: the role of accounting and non-accounting controls", *Financial Accountability and Management*, Vol. 2, pp. 142-156.
5. Agrizzi, D., (2008), "Assessing english hospitals: contradiction and conflict", *Journal of Accounting & Organizational Change*, Vol. 4, Nº 3, pp. 222-242.
6. Anthony, R. & V. Govindarajan, (2003), Management Control Systems, 11th edition, McGraw-Hill.

7. Anthony, R. (1965), Planning and Control Sytems: A Framework for Analysis, Harvard Business Press.
8. Bourn, M., e M. Ezzamel, (1986), "Costing and budgeting in the NHS", *Financial Accountability & Management*, Vol. 2, Nº 1, pp. 53-72.
9. Bouwens, J. & M. A. Abernethy, (2000), "The consequences of customization on management accounting system design", *Accounting, Organizations and Society*, Vol. 25, pp. 221-241.
10. Broadbent, J. e J. Guthrie, (1992), "Changes in the public sector: a review of "alternative" accounting research", *Accounting, Auditing & Accountability Journal*, Vol. 5, Nº 2, pp. 3-31.
11. Chenhall, R. H., (2003), "Management control systems design within its organizational context: findings from contingency-based research and directions for the future", Accounting, Organizations and Society, Vol. 28, pp. 127-168.
12. Chua, W. F. e A. Preston, (1994), "Worrying about accounting in health care", *Accounting, Auditing & Accountability Journal*, Vol. 7, Nº 3, pp. 4-17.
13. Daniel, S. J. & W. D. Reitsperger (1991), "Linking quality strategy with management control systems: empirical evidence from japanese industry", *Accounting, Organizations and Society*, Vol. 16, pp. 601-618.
14. Doolin, B. (1999), "Casemix management in a New Zealand hospital: rationalisation and resistance", *Financial Accountability and Management*, Vol. 14, Nº 3 e 4, pp. 397-417.
15. Evans, P. e S. Bellamy (1995), "Performance Evaluation in the Australian public sector - The role of management and cost accounting systems", *International Journal of Public Sector Management*, Vol. 8, Nº 6, pp. 30-38.
16. Ferreira & Otley (2009), "The design and use of performance management systems: An extended framework for analysis", Management Accounting Research, 20, pp. 263-282
17. Fisher, J. G. (1998), "Contingency theory, management control systems and firm outcomes: past results and future directions", *Behavioural Research in Accounting*, Vol. 10 (Supplement), pp. 47-64.
18. Goddard, A. (1997), "Organizational culture and budgetary control in a UK local government organization", *Accounting and Business Research*, Vol. 27, Nº 2, pp. 111-123.
19. Hill, N. (2000), "Adoption of costing systems in US hospitals: An event story analysis 1980-1990", *Journal of Accounting and Public Policy*, Vol. 19, pp. 41-71.
20. Ittner, C. D. & D. F. Larcker (1995), "Total quality management and the choice of information and reward systems", *Journal of Accounting Research*, Vol. 33, pp. 1-34
21. Jacobs, K. (1998), "Costing health care: a study of the introduction of cost and budget reports into a GP association", *Management Accounting Research*, Vol. 9, pp. 55-70.
22. Kaplan, R. S. e D. P. Norton (1996), The Balanced Scorecard: Translating Strategy into Action. Boston, Massachusetts: Harvard Business School Press.
23. Kaplan, R. S. & D. P. Norton (2001). The Strategy Focused Organization: How BalancedScore Card Companies Thrive in the New Business Environment, Boston: Harvard Business School Press.
24. Kurunmaki, L., I. Lapsley e K. Melia (2003), "Accountingization v. legitimation: a comparative study of the use of accounting information in intensive care", *Management Accounting Research*, Vol. 14, pp. 112-139.
25. Lachmann, M. (2007), "The impact of changes in health care financing on management accounting in hospitals", *European Accounting Association*, *30th Annual Congress*, Lisbon, Abril.
26. Lapsley, I. (1998), "Constructing health care accountants: melding calculation and care", *Management Accounting Research*, Vol. 9, pp. 31-35.

27. Lapsley, I. (1999), "Accounting and the new public management: instruments of substantive efficiency or a rationalising modernity?", *Financial Accountability and Management*, Vol. 15, Nº 3-4, pp. 201-207.
28. Llewellyn, F. e T. Stewart (1993), "Linking costs with quality in health and social care: new challenges for management accounting", *Financial Accountability & Management*, Vol. 9, Nº 3, 177-194.
29. Mayle, D. T., C. M. Hinton, G. A. J. Francis e J. A. Holloway (2002), "What really goes on in the name of benchmarking?", in *Business Performance Measurement: Theory and Practice*, A. Neely (editor), pp. 211-224, Cambridge University Press.
30. Mendoza e Zrihen (1997), "Le tableau de bord: en V. O. ou en version américaine?", *Revue Française de Comptabilité*, Vol. 309, pp. 60-66.
31. Miles, R. E. e C. C. Snow (1992), "Causes of failure in network organizations", *California Management Review*, Vol. 34, Nº 4, pp. 53-72.
32. Modell, S. (2004), "Performance measurement myths in the public sector: a research note", *Financial Accountability and Management*, Vol. 20, Nº 1, pp. 39-55.
33. Nyland, K. e I. Pettersen (2004), "The control gap: the role of budgets, accounting information and (non) decisions in hospital settings", *Financial Accountability & Management*, Vol. 20, Nº 1, pp. 77-102.
34. Otley, D. & A. Berry (1980), "Control, organization and accounting", Accounting, Organizations and Society, Vol. 5, pp. 231-244.
35. Otley, D. T. (1999), "Performance management: a framework for management control systems research", Management Accounting Research, Vol. 10, pp. 363-382.
36. Otley, D. (2008), "Did Kaplan and Johnson get it right?", Accounting, Auditing & Accountability Journal, Vol. 21, pp. 229-239.
37. Peden, A. e J. Baker (2002), "Allocating physicians overhead costs to services: an econometric/accounting-activity-based-approach", *Journal of Health Care Finance*, Vol. 29, Nº 1, pp. 57-75.
38. Preston, A. M., D. J. Cooper & R. W. Coombs (1992), "Fabricating Budgets: A Study of the Production of Management Budgeting in the National Health Service", *Accounting, Organizations and* Society, Vol.17, Nº 5/6, pp. 561-593.Scott, T. W. & P. Tiessen (1999), "Performance measurement and managerial teams", *Accounting, Organizations and Society*, Vol. 24, Nº 3, pp. 263-285.
39. Quattrone, P. e T. Hopper (2001), "What does organisational change mean? speculations on taken for granted category", *Management Accounting Research*, Vol. 12, Nº 4, pp. 403-435.
40. Ross, T. (2004), "Analysing health care operations using ABC", *Journal of Health Care Finance*, Vol. 30, Nº 3, pp. 1-20.
41. Shortell, S. M., R. Gillies, D. A. Anderson, K. M. Erickson & J. B. Mitchell (1996), Remaking Heath Care in America: Building Organized Delivery Systems, San Francisco: Jossey Bass.
42. Simons, R. (1995), Levers of Control: How Managers Use Innovative Control Systems to Drive Strategic Renewal, Boston: Harvard Business School Press.
43. Skærbæk., P. e J. Thisted (2004), "Unit costs in central government annual reports: a critical appraisal of the practices developed", *European Accounting Review*, Vol. 13, Nº 1, pp. 7-38.

CRITICAL SUCCESS FACTORS OF STARTUP ACCELERATORS

Monika Rostarova
Comenius University, Faculty of Management, Department of Economy and Finance, Odbojarov 10, 820 05, Bratislava, Slovakia
monika.rostarova@fm.uniba.sk

Jan Janac
Comenius University, Faculty of Management, Department of Economy and Finance, Odbojarov 10, 820 05, Bratislava, Slovakia
jan.janac@fm.uniba.sk

ABSTRACT

Startup accelerators are a phenomenon within enterprises caused by the dynamic startup rate nowadays. There are a few successful companies in this field have a massive impact on younger competitors and startup ecosystems. This publication presents the results of data analysis of different startup accelerators. The research sample was collected according to the value of funding their startups have raised. We analyzed the influence of particular parts of accelerators business models on their financial results and their success. This research article is a partial result of three years 'research so that we were able to identify the financial success of participants 'business model and to measure it and to compare results of the whole research sample. The important part of business model are an average amount of investment into startups in program and an average equity share in program graduates We analyzed the value and the optimal number of startup exits in several accelerators. We compared nonfinancial benefits provided by accelerators such as the average investment, the average share in startups, the type of investment, the sector of investment, the life cycle stage, coworking space, mentoring, demo day organization and tested their influence on the financial results of the research sample. The article results in recommended acceleration program according to financial results. Publication summarizes the list of nonfinancial benefits according the outputs of the comparative and qualitative analysis.

Keywords: *Accelerator, Exit, Funding, Seed, Venture Capital*

1. INTRODUCION

A dynamic and global environment reveals Start-up as a new type of company. Some authors consider Start-ups as a totally new phenomenon of the present era, others claims that Start-ups have been here for several years. There are opinions that very similar forms of companies have been existing for decades of years, but there wasn´t any common definition for them. Business incubators have been existing for years but they were not called Start-ups. Accelerators are definitely new institutions which are connected with the Start-up era and ecosystem. According to Crunchbase Global Innovation Investment report: *"Venture is a global business, now more than ever, with a growing percentage of financing taking place outside Silicon Valley as an expending array of innovation hubs compete for capital. In 2016, Crunchbase reported 83% of venture financing taking place outside of Silicon Valey."* (SEED DATABASE, (2016)). Start-up accelerators belong to first venture capital investors who support Start-ups in the beginning of their life cycles.

2. LITERATURE REVIEW

According to theoretical studies, there are several pillars of acceleration programs. Some of them are in common with an incubation program, but in this article we consider an incubation program as a part of acceleration program.

Mentioned pillars of acceleration are namely the following: founders and their experience, a focus of the program (sector, stage of lifecycle/investment), program's objectives, internal investment size, educational/training program, incubation (free coworking, consulting, mentoring) and a brand of accelerator (networking, demo days, connection to future capital).(KOTTULOVÁ, J.,- MITKOVÁ, Ľ. (2016)). Every accelerator has its own brand and it is the most visible element in the public acceleration. Start-ups appreciate an influential brand. Accelerator members understand it as the wide network of mentors and investors. The management of the institution can communicate with them and they guarantee a goodwill and a reputation. (CHRISTIANSEN, J. (2009)) Accelerators often commemorate conferences or events where Start-ups present their ideas to investors. Mentioned type of events is usually called Demo Days or Investor Days. Start-ups consider a connection with future venture capital as the biggest benefit of acceleration program. Financial goals of accelerators can be measured by financial indicators. We can use them to measure the productivity of investment, the rentability of employed capital or the profitability of long-term invested capital by rentability indicators. The term means a total profit from investment. (ŠLAHOR, L., BARTEKOVÁ, M.(2016))The return of investment is the most common indicator of investment measurement and every financial manager uses it in financial analysis or ratio analysis. The ratio is calculated from provided investments and incomes linked to Start-ups in accelerator´s portfolio. The results in return can be connected with the financial rewards of management. (KOMORNÍK, J. - MAJERČÁKOVÁ, D. (2015))

Venture capital is defined as a source of financing for new businesses. Venture capital funds pool investors' cash and loan it to start-up firms and small businesses with perceived, long-term growth potential. *Venture capital is the most important way of funding start-ups that do not have access to their own capital. Described capital entails high risk and potentially high returns for the investor. There are several types of venture capital and they differ in start-up's stage and amount of investment. Individual investors usually invest mainly one type of capital.* (RENTKOVA, K.- RENTKOVA, A., (2012)). **Pre- seed capital** is used for financing of ideas and research project with the goal of building a successful company around it in later stages. Pre- seed start-up are working on the business model and description of value creation for future customers.

Seed capital represents sources used for a market research and all activities before company´s establishment. *Investor finances the testing of investee´s entrepreneurship with seed capital. Seed financings may be directed toward product development, market research, building a management team and developing a business plan* (RENTKOVÁ, K. – ROŠTÁROVÁ, M., (2016)). A genuine seed-stage company has usually not yet established commercial operations - a cash infusion to fund continued research and product development is essential. These early companies are typically quite difficult business opportunities to finance.

Start- up capital is applied to overlap initial costs including purchase of new machinery and equipment, purchasing of technologies, development of technologies, initial costs for marketing etc. Start- up capital is used for financing of start-up for first two years of operation. **Growth capital** represents a funding to the initial growth of company. The phase of financing starts when the final product is created and a testing stage is finished and validated by customers in comparison to start-up capital. Money from growth capital cover marketing costs and expansion. (MILLER, P.- BOUND, K. (2011))

Some US authors and researchers in start-up field use the term early **stage capital**. Mentioned term is connected with the capital which has been used for first three years of company´s operation. Early stage capital divides into start-up capital and growth capital. We consider start-up capital and growth capital as early stage capital in this article.

3. RESEARCH QUESTION AND METHODOLOGY

One of Authors is a PhD Candidate and her thesis deals with Start-up accelerators' and incubators' business models. The thesis analyses the business models and programs of existing accelerators. The empirical part of this article will be based on data collected from research databases and statistics analyses of research participants. We use a methods of comparison and statistical analysis in case of program traits of accelerators. The theoretical part of publication presents the results of synthesis and analysis of the latest literature and scientific publications in which the issue of accelerators, their programs, startups and other companies was analyzed.

We analyze data of 188 research accelerators registered in the research platform Crunchbase. The mean of accelerators 'existence is 5, 28 years. The majority of companies is situated in US, but the research includes 5 multinational accelerators and there are companies of all world continents included.

The research question is formulated as following: *"What is the list of critical success indicators of Start-up accelerators? Which variables have a significant impact on the financial results of accelerators?"*

RESULTS

Table 1: Results of Descriptive Statistics

Descriptive Statistics			
	Mean	Standard Deviation	Count
Operation in years	5,28	1,9	178
Number of Supported Start-ups	35,27	114,28	188
Number of Exits	4,74	16,743	183
Received Investments	€126 410 333	€ 961 048 381	188
Number of Supported Start-ups/ Year	5,41	11,755	180
Average Internal Investment/ Start-up	€35 282	€35 344	169
Average Share/ Start-up	7,25	3,70	144
Return of Investment	0,2211	1,36897	146
Value of Exits	€46 766 675	€352 330 040	116

Source: Authors

Table 1 describes the average age of the research sample. Analyzed accelerators operate 5,28 years where the standard deviation is 1,9 year. The research sample mainly consists of long-term operating companies, if we consider the freshness of start-up entrepreneurship. We were able to identify the length of operation in 178 subjects. The mode of research sample is 5 years, where 30,9% accelerators have been operating for 5 years and 19,1 % was established 6 years ago.

Some subjects stopped their business activities during the 3 years research and due to this reason the minimum of variable is 0 years. On the other hand the maximum variable value reached 12 years.

We identified the exact number of supported Start-ups during the existence of all participants. The mean number results in 35,27 projects accompanied with the standard deviation 114,28 caused by the different length of operation in our research sample.

The total number of Start-ups, which have finished the acceleration up to date, is a very important identificator of accelerator success. On the other hand, the number of supported Start-ups per one year is a more accurate criteria for the scheme of business model. Mentioned variable reached 5,41 projects with the calculated standard deviation 11,76.

Many respondents did not reach any exits, so that their variables Value of exits and Number of exits had a minimum 0 value. We calculated different exit values in the research sample and as a consequence the mode of variables is equal to their minimum (0) and the median was identified as 1 exit for Number of Exit and 0 for Value of exits. Accelerators on average participated in 4,74 exits with the standard deviation 16,74 inflicted by the most successful accelerators with outstanding financial results. The average exits´ financial value reached **46 766 675 Euros** and we were able to calculate it for 116 participants. We removed the outstanding variable values measured more than 3 standard deviations from other testing and statistical analyses.

The sum of average internal investment provided by accelerator to Start-ups in its acceleration program was identified as 35 183 Eur. The mode reached 20 000 Eur and median 24 000 Eur. The minimal investment amount was 3500 Eur and the maximal sum offered to Start-ups was identified as 250 000 Eur. We can compare it with the average share of accelerators in their projects reached in 7,25%. Median is almost equal to mean (7%) and mode reached 6%. Just a few subjects do not invest in Start-ups in exchange with shares and their value is minimal (0). Maximal identified percentage of shares was 30% with the standard deviation 3,7 %.

The acceleration goal is to gain an external support and as the reason of this fact we focused on the variable Received investments. The variable represents external financing provided by investors to Start-ups in the acceleration program. Internal investments of accelerators and Start-up founders are not included. The average sum of external investments was calculated as **126 410 333** Eur. Mode and the minimal sum was 0, median 2 833 007 Eur and the maximal value reached 12 692 816 884 Eur.

The return of accelerators´ investment was calculated for 146 research subjects. The average return of investment reached 0,22 with 1,37 return as the standard deviation. Despite very high values of other cardinal variables linked to financial results, 89,5% of subjects have a zero investment return from their accelerated projects. A significantly positive return of investment for accelerators, founders and external investors can be usually recognized 5 and more years after Start-ups establishment.

Firstly, we analyzed the impact of investing in particular Start-up life stages on success indicators defined by variables Received Investments, Number of Exits,Value of Exits. We recognized a high significance for accelerators dealing with Start-ups in the early stage of life cycle. The rest of stages (pre-seed, seed, later) don´t correlate with the success indicators. Table 2 summarizes the t- test results.

Table 2: Early Stage influence on Received Investments, Number of Exits,Value of Exits

	Early stage	Count	Mean	Significance
Received Investments	no	130	€19 691,23	
	yes	58	€365 608,31	0,000
Number of Exits	no	128	1,82	0,000
	yes	55	11,53	
Value of Exits	no	79	5 373 427	0,001
	yes	37	135 146 854	
Return of Investment	no	9	0,14	0,000
	yes	13	1,89	

Source: Authors (results of nonparametric t-tests)

We identified several sectors, on which accelerators focus, causing positive impact on external funding. We tested the most represented sectors in the research sample as following: software, hardware, healthcare, education, digital, mobile, media, finance and insurance. The significant sectors are summarized in Table 3. Moreover, software, hardware, healthcare, mobile and digital sectors can radically influence both variables of exits. The extremely high significance 0,000 was measured with the variable Value of Exits in all mentioned sectors. The results vary to some extant for Number of Exits within sectors: healthcare and digital (0,000), hardware (0,002), mobile (0,003) and software (0,016). On the other hand acceleration programs oriented widely on tech Start-ups can have significantly negative impact on both variables Number of Exits and Value of Exits. We were able to recognize potential positive dependence (0,000) between software oriented accelerators and the rate of investment return in the research sample.

Table 3: Sectors and Received Investments

- *Ends on the next page* -

Hardware		Count	Mean	**Significance**
Received Investments	no	173	€61 330 851	0,000
	yes	15	€876 993 684	
Healthcare				
Received Investments	no	164	€37 925 037	0,000
	yes	24	€731 059 852	

Digital				
Received Investments	no	167	€37 430 628	0,000
	yes	21	€834 010 843	
Mobile				
Received Investments	no	156	€41 848 298	0,000
	yes	32	€538 650 250	

Source: Authors (results of nonparametric t-tests)

We assumed that the organization of demo days will influence the financial results of research sample through the variable Received Investments. Demo day is a special type of event, where Start-ups pitch to investors to receive funding, so that accelerators with demo days could be more successful. According to t- test analysis there is no impact of demo days on the sum of external funding. We identified significant relationships between demo days and other success indicators: Number of Exits (0,031) and Return of Investment (0,037). Demo Days don´t correlate with Value of Exits, but the demo days organizers successfully exited 8,81 companies and the average of variable for accelerators without demo days in their programs represents 1,03 exits. The long-term financial success in the form of higher investment return can consequenced by demo days too.

We have been testing the influence of accelerator´s location on external investments. Subjects situated in the US have higher average sum of funding in comparison to accelerators headquartered and located in other territories (significance 0,037). We didn´t find any remarkable relationship in the lasting locations (Europe, India, Africa, North America, Asia, South America). We identified a significant relation between the location of accelerator and the return of investment in European participating companies (0,014). The influence of location in the US was not enough significant to prove a relation. We assume that the result is caused by the higher average number of supported projects in the US comparing to Europe and more conservative sum of internal funding in Europe.

4. CONCLUSION

The goal of this publication was to analyze which variables characteristic for acceleration programs are linked to the success of accelerators. We studied the impact on the sum of external funding, the number of successful exits, and the financial value of realized exits and the return of investment. We identified significant relationships between following variables:

- Stage of Start-up lifecycle: Received investments, Number of Exits, Value of Exits, Return of Investment
- Start-up sector: Received investments, Number of Exits, Value of Exits, Return of Investment
- Demo days organization: Number of Exits, Return of Investment
- Location of accelerator: Received investments, Return of Investment

We can for the list of recommendations according to our results. Start-up accelerator should work with projects in early stage of their lifecycle. Interesting sectors for accelerators and investors both are: software, hardware, healthcare, digital and mobile.

Accelerator should organize Demo days as one of benefits for their Start-ups, because they can influence their investment return rate. The location of accelerators is important and there is more venture capital in the US, but European accelerators reach a higher return.

LITERATURE:

1. Christiansen, J. (2009). 'Copying Y Combinator.' Cambridge University, 2009, s. 27
2. Komorník, J. - Majerčáková, D. (2015) ,Úvod do finančného manažmentu.' Kartprint, Bratislava.
3. Kottulová, J.,- Mitková, Ľ. (2016). 'The technology start-up scene in Slovakia: No woman´s land?' In: Innovation, management, entrepreneurship and corporate sustainability: Proceedings of the 4th international conference Praha: Vysoká škola ekonomická v Praze, 2016. S. 328-337. ISBN 978-80-245-2153-4
4. Miller, P.- Bound, K. (2011).' The Startup Factories.' NESTA, 2011, s. 21.
5. Rentková, K. – Roštárová, M. (2016). 'Analysis of start-up investments in European region.' In: Innovation management and education excellence vision 2020: from regional development sustainnability to global growth. Norristown, PA: IBIMA, 2016. S.1946-1956.
6. Rentková, K. (2012). 'Manažment projektovfinancovaných zo štrukturálnych fondov Európskej únie' In: Theory of management 6: the selected problems for the development support of management knowledge base Žilina : Edis, 2012. . - S. 123-127. ISBN: 978-80-554-0591-9
7. Rentková, K. – Renková, A. (2012). 'The analysis of the regional policy progress in the European Union and in the Slovak Republic' In: Management in theory and practise: Comenius University in Bratislava, 2012. . - S. 331-347. ISBN: 978-80-554-0591-9
8. Roštárová, M. (2015). 'Nefinančné formy podpory startupov.' In Podnikateľské modely a podnikateľské stratégie startupov I.: recenzovaný zborník vedeckých prác. Bratislava : EKONÓM, 2015, s. 236-237
9. Seed database (2016): 'Database' [online]. 2016, [cit. 2017-15-01]. Online:http://www.seed-db.com/accelerators/view?acceleratorid=3012
10. Šlahor, L., Barteková, M.(2016). 'A short survey on non-maturity deposits modelling in slovakian banking sector.' In: Innovation management and education excellence vision 2020: from regional development sustainability to global growth. Norristown, PA : IBIMA, 2016. S. 1347-1355

THE EMPIRICAL EVIDENCE ON CAPITAL ADEQUACY RATIO EXPLANATORY VARIABLES FOR BANKS IN EUROPEAN UNION

Branko Soric
The University Department of Professional Studies, Split, Croatia
bsoric@oss.unist.hr

Toni Susak
Faculty of Economics, Split, Croatia
tsusak@efst.hr
The University Department of Professional Studies, Split, Croatia
tsusak@oss.unist.hr

Ivan Peronja
Faculty of Maritime Studies, Split, Croatia
iperonja@pfst.hr

ABSTRACT
Banking system is the vital part of any financial system because of it's role in acceleration of the economic activity. Firstly, central banks have function of providing the framework for activities in commercial banking as well as the function of controlling activities undertaken by the commercial banks. Commercial banks are primarily perceived as financial intermediaries between depositors and investors. Financial stability largely depends on performance of banking system entities. Banks as legal persons have to assess risk and determine the level of risk they are willing to bear. In practice, these risks can be underestimated, meaning that the bank is exposed to losses. In order to analyse how bank is resistant to aforementioned events, capital adequacy ratio is used. Capital adequacy ratio (CAR), as a measure of capitalization of a certain bank, is calculated as a ratio of bank capital and risk-weighted assets. Minimum capital adequacy ratio is determined by the international standards because banks can absorb a reasonable level of losses before they become insolvent. It serves to protect depositors and promote stability and efficiency of a banking system. The aim of this paper is to statistically analyse determinants of capital adequacy ratio for banks which operate in certain countries which are part of European Union.
Keywords: *Capital adequacy ratio, Banks, Determinants, European Union*

1. INTRODUCTION TO CAPITAL ADEQUACY

Bank capital is the difference between bank's assets and liabilities, and it represents the net worth of the bank or its value to investors. “The asset portion of bank's capital includes cash, government securities and interest-earning loans, such as mortgages, letters of credit and inter-bank loans, while the liabilities section of a bank's capital includes loan-loss reserves and any debt it owes” (Investopedia). Capital is considered as a key factor for long-term market sustainability of banks and a mean of remedying various business problems. It is also the primary indicator of financial strength and security of the bank and its ability to absorb potential unforeseen losses and negative financial movements, which may have a devastating effect on the solvency and vitality of the bank. Insolvency of a bank, which results from overtaking too high business risk, is transferred to the system as a whole, through the fear of depositors, to the illiquidity of the economy, and thus to the illiquidity of the entire banking and economic system. The capital adequacy concept derives from the solvency of the bank,

its ability to absorb the risks to which it is exposed, while maintaining its business capability. Banks must have equity that is adequate to its liabilities and risks, to ensure financial stability in the business. The role of capital in banks is multiple: ensures the beginning and continuity of business operations, protects the bank from losses, limits its over-expansion, constitutes the basis for profitability calculation, hedges depositors etc. (Sorić, 2010, p. 48). Successfully managed and profitable banks can operate with small amounts of capital, given that no amount of capital can guarantee the stability and viability of a bank that operates badly and does not repay their liabilities. If a bank always generates excess revenue over its expenses, its capital would not be needed to absorb losses, but rather as the basis for dividend distribution to shareholders. However, the true meaning of capital is reflected in the fact that it covers unexpected, unpredictable losses. In that case, the mechanism of bank capital to absorb losses is activated. Large losses, which exceed the amount of capital, lead to liquidation of a particular bank. Although capital has a secondary and limited role, it is very important in maintaining the financial strength and credibility of the bank. Banking capital is the function of the risk that a bank takes, that is, if a bank prefers higher profits and accordingly takes greater risk, it is normal that it has to increase its capital.

2. MEASURING CAPITAL ADEQUACY

Capital adequacy measurement from the aspect of a manager and a shareholder may differ from the assessment of regulatory bodies because regulators are primarily interested in bank's security and stability of the financial system and, accordingly, they require higher capital ratios. On the other hand, the aim of the shareholder and the manager is, besides providing solvency, to achieve higher profit per unit of equity. The fact that they prefer profitability, leads them to more significant use of financial leverage and reduction of the rate of share capital. Banks with a lower level of capital adequacy can involve in more risky projects and achieve higher profitability (Andreis et al., 2016). Subjectivity when measuring capital adequacy and bank development over time has influenced that the regulation of capital adequacy standards varies over time, depending on the type and size of the bank and the requirements of regulatory institutions. Although capital adequacy ratio can be measured as capital / deposit and capital / total assets, the most common capital adequacy measure is capital / risk weighted assets.

Risky assets are defined as total assets minus cash and government securities, since these two items are practically without risk, so they should be excluded from total assets when the risk is measured. The Basel Committee adopted an international risk capital standard as a capital adequacy coefficient (which shows the ratio of capital and risk weighted assets) in 1988. Its full implementation started on 1st January 1993.

The Basel Accord adopted the standard classification of bank capital into Tier I and Tier II capital. The sum of primary and secondary capital makes up the total capital. Risk weighted assets represent the risk capital coefficient of capital adequacy ratio and consist of two components: risk-adjusted balance sheet assets and risk-adjusted off-balance sheet assets. According to credit risk exposure, each bank must classify its assets in one of the following four categories – 0%, 20%, 50% and 100%.
The weighted risk value of banking assets is obtained by multiplying the book value of assets and the corresponding risk weight (Cornett & Saunders, 1999, p. 373):

$$\sum_{i=1}^{n} w_i a_i$$

where:

- Wi – asset risk weight,
- ai – asset book value in balance sheet.

Unlike a simple leverage indicator, calculating capital adequacy based on risk is very complex. The main innovation is that the risk-based indicator distinguishes between different credit risk assets and identifies the credit risk associated with off-balance sheet instruments.

The Basel I Accord on capital adequacy had many shortcomings (it prefers type but not quality of the asset, i.e. it does not recognize the differences in the quality of credit risk, does not take into account other banking risks such as operational risk, neglects possibility of reducing credit risk through diversification of assets), so in 1999. a new proposal of the Accord was adopted, whose implementation began in 2004.

The new Accord about capital provided new incentives for banks to improve their risk measurement procedures, especially market and operational risks, and foresaw changes in the underlying model of calculating the capital adequacy ratio. Basel II provides banks with different approaches when assessing capital adequacy. The basic approach is the "standardized approach" which is very similar to the first standard. The only difference is that risk weights are based on external credit rating of borrowers. Banks are also allowed to reduce assumed risks through guarantees, collateral and financial derivatives.

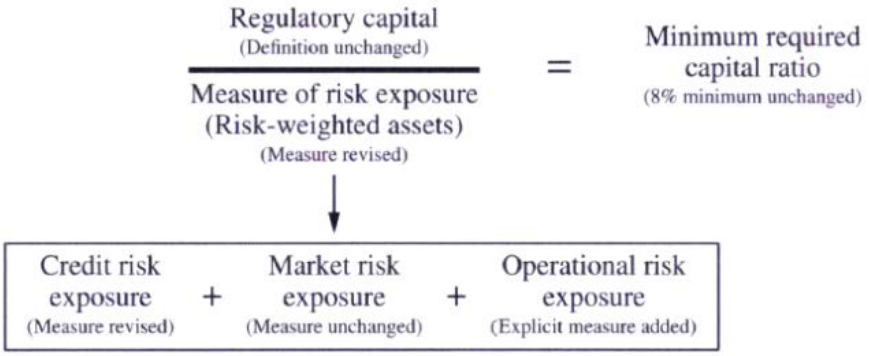


Figure 1. *Calculation of capital ratio – Basel II (**Source:** Ferguson, R.W., Basel II, 2003., p. 398.)*

The emphasis on the banking internal capital adequacy assessment models, so-called "Internal Ratings Based Approach" (IRB) was introduced - regulatory requirements for capital are based on the internal assessment of credit quality of each borrower by the bank. In order to use the IRB approach, banks must meet the minimum requirements of the supervisory authorities, which perform control of internal assessment.

The most renowned internal capital adequacy measurement model is Value at Risk (VaR). VaR represents a cash sum that should be sufficient to cover the significant amount of potential losses (Nuxoll, 1999, p. 19).

The meaning of quantitative risk-based valuation consists of calculating the required Capital at Risk (CaR), which is treated as the ultimate buffer for losses and protection of the bank from insolvency.

$$CAR = \frac{Tier\ One\ Capital + Tier\ Two\ Capital}{Risk\ Weighted\ Assets}$$

In response to the global crisis and the tightening of banking business regulations, a new, more stringent capital adequacy rule was approved in September 2010. under Basel III with effects in 2013. (Kiselakova et al., 2013). Basel III increases the scope of risk, involves higher capital quality and combines micro and macro-prudential supervision.

3. VARIABLES, STATISTICAL METHODOLOGY, SAMPLE AND RESULTS OF STATISTICAL ANALYSIS

3.1. Variables included in research

3.1.1. Return on assets

ROA is a measure of bank profitability that demonstrates the quality of using assets. It is also a measure of managerial efficiency in bank management. Return on Assets (ROA) is calculated as the ratio of profit after taxation and average assets. ROA shows how much cents bank has earned on each dollar of assets. The desired ROA level depends on the intensity of the company's assets. The success of a bank is reflected if the return on the asset is greater than 1%.

3.1.2. Liquidity

Liquidity is defined as the ability of the bank to fulfill its obligations within maturity and is determined by compatibility of maturity of assets and liabilities. High liquidity reduces income and affects returns. High liquidity can also indicate lower interest rates. Low interest rates will result in higher demand for loans because the loan is inexpensive. In this way, high liquidity in banks is stimulating economic growth.

Bank liquidity can be measured using three indicators:
1. ratio of liquid assets and total assets,
2. ratio of liquid assets and total deposits, and
3. ratio of total loans and total assets of the bank.

In our research, we decided to use the third indicator. Loans are less liquid than other assets of the bank. Therefore, the higher the value of this indicator means the lower liquidity of bank. However, loans may have higher rates of return than other assets, which can positively affect profitability. Also, it is important to pay attention to the quality of the loan portfolio.

3.1.3. Deposit ratio

Deposits ratio (DR) is the ratio of deposits held by the bank and the total assets. The deposit ratio shows how much attracted deposits contribute to the financing of bank assets. Deposits are the main and cost-effective source of financing for bank. Although many banks may borrow in world capital markets, deposits are still the cheapest and most stable component of banking resources. The assumption is that there is a direct link between the share of deposits in bank assets and its profitability.

3.1.4. Size of a company

Size of a company is measured as natural logarithm of total assets of a company.

Table 2. *Financial ratios included in statistical analysis*

Financial Ratio	Abbrev.	Formula
Capital Adequacy	CA	Equity / Total Assets
ROA	ROA	Profit before taxes / Total Assets
Liquidity	LQ	Net loans / Total Assets
Deposit Ratio	DR	Total deposit / Total Assets
ln (Total Assets)	ln (TA)	

Table 2. shows variables included in research. Capital adequacy ratio was analysed as dependent variable, while return on assets, liquidity, deposit ratio and size of a company were included as dependent variables.

3.2. Sample and statistical methodology and results of statistical analysis

As a research methodology, multiple regression (MR) was used to analyse explanatory variables. Sample comprises 93 banks from several European Union countries (Croatia, Hungary, Slovakia, Slovenia, Czech Republic, Austria, Romania, Bulgaria and Poland). In order to keep analysis methodologically reliable, following recommendations were applied: "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)" (Mladineo & Šušak, 2016).

Table 3. *Correlations and collinearity statistics*

	Correlations			Collinearity Statistics	
	Zero-order	**Partial**	**Part**	**Tolerance**	**VIF**
(Constant)					
ln (total assets)	-0,069	-0,111	-0,108	0,853	1,173
ROA	-0,005	0,052	0,050	0,928	1,077
LQ	0,102	0,084	0,082	0,949	1,053
DR	-0,207	-0,232	-0,230	0,924	1,083

Software used in analysis: IBM Corp.: IBM SPSS Statistics for Windows, Version 22.0., Armonk: NY: IBM Corp., 2013.

According to the **Table 3.**, there is no multicollinearity problem between variables in multiple regression model.

Table 4. *MR model coefficients*

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	0,259	0,063		4,139	0,0001	0,135	0,383
ln (total assets)	-0,003	0,003	-0,117	-1,050	0,297	-0,008	0,003
ROA	0,117	0,242	0,052	0,484	0,629	-0,363	0,597
LQ	0,028	0,035	0,084	0,795	0,429	-0,041	0,097
DR	-0,075	0,034	-0,239	-2,233	0,028	-0,142	-0,008

Software used in analysis: IBM Corp.: IBM SPSS Statistics for Windows, Version 22.0., Armonk: NY: IBM Corp., 2013.

Model equation:

$$\mathbf{CA} = 0{,}259 - 0{,}003*\ln(TA) + 0{,}117*ROA + 0{,}028*LQ - 0{,}075*DR$$

Abbreviations: CA – capital adequacy; ln (TA) – size of a company; ROA – return on assets; LQ – liquidity; DR – deposit ratio.

The aim of statistical analysis was to analyse contribution of certain variable in prediction of CA. Positive relationship with capital adequacy have ROA and LQ, while there is negative relationship with ln (TA) and DR. Highest contribution to the prediction of dependent variable is made by DR, which also makes statistically significant contribution to the CA. Other variables are not statistically significant at 5% significance level.

4. CONCLUSION

The purpose of bank's capital is primarily to absorb sudden, unforeseen market shocks. The regulator has determined the minimum capital adequacy that each bank has to meet. Banks with high capital adequacy rates work cautiously but ignore potentially profitable investments. Large international banks have more access to capital markets so they can have the minimum statutory capital adequacy rate and redirect surpluses to profitable investments. In this survey which included 93 banks from the EU the relationship between certain variables and capital adequacy was measured. Results of statistical analysis have shown that variables ROA and LQ have positive relationship with capital adequacy and negative relationship with ln (TA) and DR. Highest contribution (and also statistically significant) to the prediction of dependent variable is made by DR.

LITERATURE:

1. Andreis, AM, Capraru, B., Muntean, F., Ihnatov, I., The Impact of International Financial Crisis of Bank Performance in Eastern and Central European Countries, EuroEconomica, Vol 35, No 1, 2016.
2. 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
3. Cornet, M.M., Saunders, A., Fundamentals of Financial Institutions Management, Irwin McGraw – Hill, Singapore, 1999.
4. Investopedia. Bank capital, available at: http://www.investopedia.com/terms/b/bank-capital.asp

5. Kiselakova, D., Hečkova, J., Chapčakova, A., Trends of Development and Factors of Competitiveness Banking Sector in Global Economy – Empirial Study of Slovakia, International Journal of Finance and Accounting 2013, 2(3): 138-149
6. Mladineo L., Šušak T. (2016). Determinants of effective tax rate. 16th International Scientific Conference on Economic and Social Development, Split, 2016.
7. Nuxoll, D.A., Internal Risk – Management Models as a Basis for Capital Reqirements, FDIC Banking Reveiw, 1/1999.
8. Pallant J. (2007). SPSS Survival Manual, McGraw-Hill
9. Sorić, B., Determinante profitabilnosti banaka u Republici Hrvatskoj, 2010., Ekonomski fakultet Split, Magistarski rad
10. Stevens J. (1996). Applied multivariate statistics for the social sciences (3rd edn). Mahway, NJ: Lawrence Erlbaum

CSR REPORTING IN CROATIA: CURRENT STATE AND PERSPECTIVES

Ivo Mijoc
Faculty of Economics in Osijek, Croatia
imijoc@efos.hr

Dubravka Pekanov Starcevic
Faculty of Economics in Osijek, Croatia
dpekan@efos.hr

Josipa Mijoc
Faculty of Economics in Osijek, Croatia
jmijoc@efos.hr

ABSTRACT

Although non-financial reporting is mostly voluntary, certain categories of business entities are becoming obliged to make such reports. In addition to the lack of legislation, a significant problem in relation to these reports is the inconsistency in the methodology for their making. This paper aims at exploring corporate social responsibility reporting (CSRR) in Croatia, where, compared to other EU countries, CSRR is under-researched. Research studies were conducted on the Croatian companies listed on the Zagreb Stock Exchange. The survey questionnaire was addressed to the Chief Accounting/Financial Officer of sample companies. The results showed that the Croatian listed companies have not recognised the importance of disclosing CSR information. Companies stress the lack of a legal obligation for making these reports as the most significant reason. This situation will change at the beginning of 2017, when non-financial reporting will become mandatory for listed companies and public-interest entities in the Republic of Croatia. This will contribute to increasing the number of such reports. However, the need to set up a single framework for non-financial reporting will remain a problem.

Keywords: *corporate social responsibility, corporate social responsibility reporting, Croatia*

1. INTRODUCTION

Business sustainability issues (European Union 2001, Serenko and Bontis 2009, Du, Bhattacharya and Sen 2010), as well as sustainability reporting (Kolk 2008, Dhaliwal et al. 2011, Ioannou and Serafeim 2014), have gained growing attention in recent years. A sustainability report, also called a corporate social responsibility or triple bottom line report, is a "report published by a company or organisation about the economic, environmental and social impacts caused by its everyday activities" (GRI 2015). "Communication is an essential part of corporate social responsibility (Szczepankiewicz and Mućko 2016)." Although CSR reporting is mostly voluntary (Roca and Scarcy 2012, Bonson and Bednarova 2015), governments and stock exchanges have recently started to impose regulations and listing requirements that mandate CSR disclosure (Ioannou and Serafeim 2014). The 2015 KPMG Survey of Corporate Responsibility Reporting from 45 countries showed continued growth in corporate social responsibility reporting, but legislation is still the main driver of reporting. Furthermore, *European Union Directive 2014/95/EU* requires some companies to disclose in their reports environmental matters, social and employee aspects, and other CSR aspects. According to the European Commission (http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm), those companies include listed companies and public-interest entities (e.g., banks, insurance companies), which covers approximately 6,000 large

companies in the EU. This Directive leaves flexibility for companies to disclose their CSR information in a way they consider most appropriate. This could in turn lead to "as many types of social reporting as there are corporations" (Romolini, Fissi and Gori 2014, p. 66). Although there are corporate responsibility standards, such as Global Reporting Initiative (GRI), UN Global Compact Principles, ISO 14001 and ISO 26000, there is a need to form "an internationally recognised and generally accepted framework to achieve the uniformity in CSR reporting" (Bonson and Bednarova 2015, p. 183). GRI is the most commonly used standard (Roca and Searcy 2012, Romolini, Fissi and Gori 2014, Ioannou and Serafeim 2014) and it includes disclosure of economic, environmental and social indicators, the so-called triple bottom line (Elkington 1998). In the period 2015-2016, the European Commission has been preparing non-binding guidelines for non-financial reporting, which should be finalised by the end of 2016. Research carried out in 2013 in the Republic of Croatia, entitled *Corporate Social Responsibility for All*, showed that there are "almost no measures for CSR promotion". In addition, there were no regulatory and legislative requirements for Corporate Social Responsibility Reporting (CSRR). The proposal for the Corporate Social Responsibility Strategy in Croatia was prepared by the Croatian Business Council for Sustainable Development (HR BCSD) in 2012, but it has not been finalised yet. However, in 2013, Croatia became a European Union Member State and that imposed the need to address the question of corporate sustainability reporting. Furthermore, as of January 2017, non-financial reporting will be mandatory for listed companies and public-interest entities in the Republic of Croatia pursuant to EU Directive 2014/95. The main purpose of this paper is to discuss the state of play in CSR reporting in Croatia among listed companies and their attitude toward CSR and CSR reporting. The paper is structured as follows: after the literature review the methodology used will be presented, which is followed first by research results and then finally by a brief discussion of the key findings and conclusion.

2. LITERATURE REVIEW

A growing number of companies publish an annual corporate social responsibility report, primarily because of stakeholders' pressures (Katonen 2009, Arvidsson 2010, Gao 2011). This is in accordance with Freeman's (1984) attitude, who stated that a company should provide relevant information not only to its shareholders but also to their stakeholders. In that way, CSR reporting could contribute to minimizing information asymmetry between different stakeholders. Golob and Bartlett (2007) used cross-national comparative research to observe CSR reporting across Australia and Slovenia. The research showed that both countries have limited regulatory reporting which is mostly controlled by stock exchange guidelines and corporate law. Azim, Ahmed and Islam (2009) conducted research on listed companies in Bangladesh, where only 15.45% of listed companies made CSR disclosures. Roca and Scarcy (2012) used content analysis to investigate indicators disclosed in corporate sustainability reports in Canada. They found a great diversity in the indicators reported. Bonson and Bednarova (2015) investigated CSR reporting practices in Eurozone companies using content analysis of the annual reports of listed companies. Their results revealed an intensive use of corporate governance indicators, a moderate use of environmental and low use of social indicators. Gori, Romolini and Fissi (2012) analysed CSR disclosure of Italian listed companies by using the inductive method. Their research confirmed these companies' attention to CSR issues. In 2014, Romolini, Fissi and Gori investigated CSR reporting using extreme case sampling by choosing Italian companies with the best performance from a voluntary reporting point-of-view and found an overall good level of disclosure. Habek and Wolniak (2015) assessed the quality and level of CSRR in six EU countries. They revealed that the majority of sustainability reporters in their study were large listed companies. Furthermore, almost half of the reports in their research were prepared in accordance with the

GRI guidelines. Marfo, Chen and Xuhua (2015) examined CSRR in listed companies in Ghana and found that there is significant CSRR among them. Vitezić, Vuko and Morec (2012) investigated the relationship between financial performance and CSR disclosure in Croatia and found that larger and more profitable companies are more willing to disclose their corporate social responsibility activities. Grudić Bakić (2014) used web site content analysis and concluded that Croatian companies engage in social (95%) and environmental CSR programs (85%), but only a small portion (10%) is involved in economic CSR programs. Pekanov Starčević, Mijoč and Čuljak (2016) also used content analysis and found that Croatian companies generally do not publish separate reports related to corporate social responsibility. Peršić, Bakija and Vlašić (2015) investigated CSR reporting among Croatian listed hotel companies and concluded that sustainability reporting should be significantly improved. As a reason for Corporate Social Responsibility Reporting, Gao (2011) mentions a useful way for companies to benefit themselves, Graves and Waddock (2000) mention a marketing strategy, while Azim, Ahmed and Islam (2009) and Luo and Bhattacharya (2006) add improving a company's business image and gaining competitive advantage. Additionally, CSR can influence financial performance of a company. The majority of studies on the relationship between CSR and financial performance have shown that there is a positive relationship between those two variables (for example, recently Wood 2010, Sun 2012, Ismail and Adegbemi 2013, Bai and Chang 2015, Pekanov Starčević, Mijoč and Mijoč 2015). This paper adds to the existing literature by examining corporate social responsibility reporting in the Croatian listed companies. Following the above controversies, the aim of this paper is to test the following hypotheses:

H1: Croatian companies listed on the stock exchange have recognised the importance of preparing and disclosing CSR information.

H2: Greater implementation of CSR is a prerequisite for the company to make a decision to:

H2a: prepare CSR reports, H2b: publish CSR reports.

H3: With respect to the reasons for preparing CSP reports, companies differ in relation to:

H3a: evaluation of the significance of the lack of reporting obligations,

H3b: insufficient public interest in monitoring business operations,

H3c: financial benefits of CSR reports.

3. METHODOLOGY

3.1. Data Collection Methodology

Research that was carried out in the period from January to March 2015 focused on the Croatian listed companies (Zagreb Stock Exchange). On 25 November 2014, there were 158 such companies, as given in the public announcement of the Official Register of Regulated Information (SRPI) of the Croatian Financial Services Supervisory Agency (HANFA). The questionnaire was sent by ordinary mail and by e-mail to those 158 companies and it was addressed to the Chief Accounting Officer/Chief Financial Officer. The research itself did not include cities, companies in liquidation and delisted (unquoted) entities. The effective response rate of 50.63% (n = 80) is considered highly satisfactory (i.e., 14 and 66 questionnaires were returned by post and via e-mail, respectively). A structured questionnaire used in the study was developed for the purpose of testing and comparing comprehension of the awareness level of companies referring to the concept of corporate social responsibility and the level of their social responsibility in their own business from the accounting and financial perspective.

The questionnaire consists of two parts with a total of 32 questions. In addition to 20 general (A) questions, the structured questionnaire also contained 12 (B) demographic and business related questions. The statements of the respondents (A) were measured by a 5-point Likert scale.

3.2. Sample Description

The research sample was made up of a publicly available list of listed companies in the Republic of Croatia. As noted by Bonson and Bednarova (2015), large listed companies have been forced to disclose more information about their social and environmental impacts on society. CSR and CSRR in the listed companies were the focus of many researchers (e.g., Azim, Ahmed and Islam 2009 – 246 listed companies, Arvidsson 2010 – 18 listed companies, Gao 2011 – 81 listed companies, Romolini, Fissi and Gori 2014 – 23 listed companies, Bonson and Bednarova 2015 – 306 listed companies, Pekanov Starčević, Mijoč and Čuljak 2016 – 79 listed companies). In addition, CSR research conducted in 2007 by the UNDP Croatia (*Accelerating CSR practices in the new EU member states and candidate countries as a vehicle for harmonisation, competitiveness and social cohesion in the EU*) showed that the CSR concept is used mostly by large and listed companies and foreign-owned companies and exporters. Other studies also confirm that CSR reports are mainly published by large companies (for example, Kolk 2008, Habek and Wolniak 2015). Table 1 provides an overview of the main characteristics of the sample.

Table 2: Description of the sample (Research results)

Company activity	n	%
Manufacturing	35	43.75
Non-manufacturing	45	56.25
Total	**80**	**100.00**

Head office according to NUTS II classification	n	%
Pannonian Croatia	57	71.25
Adriatic Croatia	23	28.75
Total	**80**	**100.00**

Respondent's position within the company		
Chief financial/accounting officer	47	58.75
Accounting personnel	24	30.00
Controlling personnel	9	11.25
Total	**80**	**100.00**

Foreign ownership in the company		
0%	51	63.75
0.1 – 10%	11	13.75
10.1 – 25.00%	3	3.75
25.1 – 49.90%	3	3.75
50% or more	12	15.00
Total	**80**	**100.00**

Number of employees		
Less than 250	38	47.50
250-500	15	18.75
More than 500	27	33.75
Total	**80**	**100.00**

Head offices of the surveyed companies are located in 37 Croatian cities, and according to the NUTS II classification, 71.25% and 28.75% of those offices are located in the Pannonian Croatia and in the Adriatic Croatia, respectively. As to the respondent's position in the company, most questionnaires were filled in by Chief Financial Officers and Chief Accounting Officers (the two categories together account for 58.75% of the total number of surveyed companies), then by accounting personnel (30%), and the remaining questionnaires (i.e., 11.25%) were filled in by e.g. control officers, accounting advisors or internal auditors. The National Classification of Economic Activities 2007 was used to group companies according to their activities. Most companies are engaged in the manufacturing industry (25%), then in financial and insurance activities (16.3%), while companies involved in accommodation and food service activities and those involved in agriculture, forestry and fishing comprise 15% and 12.5% of the surveyed companies, respectively. Other activities account for the remaining 31.2%.

For the purpose of analysis, the surveyed companies were grouped into two categories, i.e., manufacturing (operators involved in manufacturing, utilities, construction, water management, agriculture, fishing and forestry) and non-manufacturing (operators involved in trade, financial and other services, transport and communications, hotels, restaurants and tourism) companies. Manufacturing and non-manufacturing companies make up 43.8% and 56.3% of the sample, respectively.

3.3. Operationalisation of variables

This section describes the process of creating the construct, i.e., Corporate Social Responsibility. Items adapted according to Flash Eurobarometer 363 conducted in all European countries, which pre-tested the validity of questions, were used in the construction of the independent variable. Six items were observed by means of which corporate social responsibility was measured. According to Pekanov Starčević et al. (2016), this construct is considered to be one-dimensional (which explains 57.63% of variance), and psychometric properties indicate internal consistency of the construct (Cronbach's alpha > 0.8, inter-item correlation > 0.4, and item-total correlation > 0.6). Accordingly, the measured *Corporate Social Responsibility* construct was developed as an average rating of 6 items.

3.3.1. Statistical analysis

Methods of univariate and bivariate statistical analysis were used for the purpose of testing the research proposition. Descriptive statistics were used to address the hypotheses referring to the frequency of application of the CSR report preparation and disclosure strategy (H1). The t-test procedure for an independent variable was used to test whether companies differ with respect to the reasons for their decision to prepare CSR reports (H3) and to test the hypothesis whether a higher degree of CSR implementation in companies is associated with a more frequent decision made by a company to prepare and disclose CSR information. Statistical IBM SPSS Statistics 23.0 is a software package used for the analysis of collected data.

4. RESULTS AND DISCUSSION

In line with theoretical assumptions, the research focus of this paper is to identify and describe the Croatian listed companies that have recognised preparation of CSR reports as their strategic advantage. On the other hand, the decision to prepare CSR reports is not sufficient to refer to socially responsible corporate behaviour. In addition to preparing CSR reports, companies would ensure the public availability by disclosing such information, which would in turn enable discussion and evaluation of their work by stakeholders. Table 2 gives results in relation to decisions made by companies to prepare, i.e., to disclose CSR information.

Table 2: Description of companies according to their decision whether to prepare and disclose CSR information or not (Research results)

CSR report preparation	n	%
Yes	28	35%
No	52	65%
Total	80	100%

CSR information disclosure	n	%
Yes	24	30%
No	56	70%
Total	80	100%

The results presented in Table 2 show that only one third of companies produces CSR reports (35%), while a slightly smaller number of these companies discloses this information (30%).

Although this table gives only descriptive statistics of the companies that produce and disclose CSR information in their respective environments, these results imply that hypothesis H1, which states that *companies listed on the stock exchange have recognised the importance of preparing and disclosing CSR information*, should be rejected.

Description of socially responsible companies involves testing of the second hypothesis in this paper (H2a and H2b), according to which it is assumed that companies that produce and disclose CSR information also show a higher degree of CSR implementation in their businesses. The independent samples t-test results are shown in Table 3.

Table 3: The independent samples t-test for measuring the CSR construct (Research results)

		Results for the construct *Corporate Social Responsibility*				
					Independent samples t-test	
		n	Mean	St. deviation	Levene's Test for Equality of Variances	t-test
CSR report preparation	Yes	24	4.22	.699	F = 0.400, p > 0.05	t = 2.47, df = 71 p = 0.02*
	No	49	3.74	.810		
CSR information disclosure	Yes	20	4.22	.711	F = 0.471, p > 0.05	t = 2.16, df = 71 p = 0.03*
	No	53	3.77	.807		

*level of significance < 0.05

After conducting the t-tests, which tested the average score difference in the measured construct *Degree of CSR Implementation* with respect to the company's decision to produce/disclose CSR information, statistically significant differences of the analysed categories were observed. Homogeneity of variance in both t-tests that were performed was not violated (i.e., H2a: $F = 0.400$, $p > 0.05$ and H2b: $F = 0.471$, $p > 0.05$). The results indicate that not enough evidence was available to reject H2a and H2b hypothesis. At the 5% significance level ($t = 2.47$, $df = 71$, $p = 0.02$), it can be concluded that companies that produce CSR reports (H2a) are those whose degree of CSR implementation in their businesses is higher (mean = 4.22, st. deviation = 0.699) than in those companies that do not produce these reports (mean = 3.74, st. deviation = 0.810). In addition, at the 5% significance level ($t = 2.16$, $df = 71$, $p = 0.03$), it can be concluded that companies that disclose CSR information (H2b) are those whose degree of CSR implementation in their businesses is higher (mean = 4.22, st. deviation = 0.711) than in those companies that do not disclose this information (mean = 3.77, st. deviation = 0.807). Companies were also asked about how future CSR reports should look like. The results show that, in order to increase transparency in their business operations, companies consider it appropriate to disclose CSR information in descriptive and statistical terms as well as by expressing monetary values (62.5% of responses), while 17.5% of them opt for descriptive and statistical display. Analysis of the remaining responses shows that 5% of respondents believes that this may be done just descriptively (declaratively), 5% opt for quantitative display, but without expressing monetary values, and 10% add display of monetary values. The reasons companies reflect upon when making their decisions to produce or not produce CSR reports (H3) are analysed in the sequel.

Table following on the next page

Table 4: The independent samples t-test for decisions to disclose CSR information (Research results)

For companies, the decision on whether to disclose information on the impact on society and the environment should be	CSR report preparation	n	Mean	St. deviation	Independent samples t-test	
					Levene's Test for Equality of Variances	t-test
voluntary	Yes	28	2.79	1.475	F = 3.261, p = 0.08	t = -1.20, df = 78, p = 0.234
	No	52	3.15	1.211		
legal	Yes	28	4.11	0.994	F = 2.970, p = 0.09	t = 2.37, df = 78, p = 0.02*
	No	52	3.52	1.093		

*level of significance < 0.05

Companies that produce CSR reports do not differ from those that do not do so with respect to the view that a decision on publishing information referring to the impact of a company on society and the environment should be voluntary ($p > 0.05$). However, if you think about the need for legislation to provide these reports, then the points of view of companies that currently produce these reports are statistically significantly different compared to the companies that currently do not produce these reports ($p = 0.02$). In other words, companies already preparing these reports believe that the introduction of legislation would be supportive and helpful to other companies that do not produce these reports. Table 5 shows the results of the independent samples t-test, the aim of which was to explore whether companies differ with respect to the reasons for making CSR reports.

Table 5: The independent samples t-test for the importance of reasons why companies (do not) make CSR reports (Research results)

Reasons why companies (do not) make CSR reports	CSR report preparation	n	Mean	St. deviation	t-test
No legal obligation or appropriate regulation	Yes	28	2.93	1.120	t = -4.02, df = 78, p < 0.001**
	No	52	3.81	.817	
Not prescribed by the Financial Reporting Standards Board	Yes	28	2.89	1.066	t = -3.10, df = 78, p = 0.003*
	No	52	3.62	.953	
Insufficient demand for this information	Yes	28	2.64	.989	t = -3.91, df = 78, p < 0.001**
	No	52	3.44	.802	
The costs exceed the profit/benefits	Yes	28	2.82	1.020	t = -1.41, df = 78, p = 0.162
	No	52	3.12	.808	
The information is sensitive and confidential	Yes	28	3.21	1.101	t = 0.89, df = 46.14, p = 0.380
	No	52	3.00	.886	
Business objectives are economic success, not social action	Yes	28	3.04	1.170	t = 0,23, df = 45.24, p = 0.830
	No	52	2.98	.918	

*level of significance < 0.05
**level of significance < 0.01

Analysis of reasons companies consider important when making a decision on (not) producing CSR reports emphasised three statistically significant differences. Companies that do not produce CSR reports stress *the non-existence of a legal obligation or appropriate regulation* as the foremost reason (mean = 3.81) and they significantly differ in this approach from the companies that produce these reports ($t = 4.02$, $df = 78$, $p < 0.001$). In addition, companies that do not produce CSR reports (mean = 3.62) are also statistically significantly different from companies that produce these reports ($t = 3.10$, $df = 78$, $p = 0.003$) with respect to an obligation not prescribed by the Financial Reporting Standards Board. In other words, companies that do not produce reports do not do that because they are not legally obliged to

do so. The aforementioned rationale presents sufficient evidence not to reject H3a hypothesis, according to which companies differ with regard to their assessment of the importance of the non-existence of a legal obligation referring to CSR reporting. Lack of public interest in the Republic of Croatia in these reports brings additional benefit to the fact that companies do not decide to produce CSR reports (H3b). This is supported by the results presented in Table 5 ($t = 3.91$, $df = 78$, $p < 0.001$), according to which there is a statistically significant difference in the attitude of companies that do not produce CSR reports, which believe that there is insufficient demand for this information (mean = 3.44) in relation to the companies that produce these reports (mean = 2.64). Although due to the rejection of H1 hypothesis we can talk about low awareness of companies of the need for producing CSR reports, the question arises as to whether companies that produce these reports are more likely to build a positive image in the business sector. Companies involved in research were asked whether *their company has been given any award by Croatian/foreign institutions in the past five years*. This is tested by means of the chi-square test procedure and shown below.

Table 6: The chi-square test – dependence of CSR reporting and awards given to a company (Research results)

CSR report preparation		Awards given by Croatian/foreign institutions		Total
		Yes	No	
Yes	n	14	14	28
	% with awards	53.8%	25.9%	35.0%
No	n	12	40	52
	% with awards	46.2%	74.1%	65.0%
Total	n	26	54	80
	% with awards	100.0%	100.0%	100.0%

The chi-square test results indicate the existence of interdependence between the analysed variables ($\chi 2 = 6.014$, $p = 0.014$). Although both companies that produce and those that do not produce CSR reports (53.8% and 46.2%, respectively) were equally given awards by Croatian/foreign institutions, a statistically significant difference is observed in the absence of these awards. According to the results presented in Table 6, it can be concluded that those companies that do not produce CSR reports mostly have no chance of receiving awards from Croatian/foreign institutions (74.1%) compared to those companies that prepare these reports (25.9%).

5. CONCLUSIONS AND RECOMMENDATIONS

This paper investigated to which extent the Croatian listed companies recognise the importance of producing CSR reports. Social responsibility and non-financial reporting have become more pronounced, regardless of the reasons for making such reports. Although in most cases non-financial reporting is voluntary, trends are such that it is becoming mandatory for certain categories of businesses. For example, from 1 January 2017, non-financial reporting becomes mandatory for listed companies and public-interest entities in the Republic of Croatia as an EU member country. This study showed that at the time of research the Croatian listed companies generally did not recognise the importance of preparing and disclosing CSR information. Companies mentioned lack of regulations that would make such reporting mandatory as an important reason for not making CSR reports. This will change beginning in 2017, and a significantly higher level of non-financial reporting is expected in the category of business entities under study. It is recommended that this research be repeated when such reporting becomes mandatory for both listed and other categories of business entities. It should also be compared to which extent companies recognise the importance of

and reasons for non-financial reporting by companies that are obliged to produce these reports, and those that are not obliged to do so. Finally, the results point to the fact that it is justified to encourage companies to produce and disclose CSR information as there is reasonable doubt that evaluation of their business operations by the public through such reports would prompt the companies to reflect and all stakeholders to be responsible, from employees to the wider community.

LITERATURE:

1. Aguinis, H. and Glavas, A. (2012).What We Know and Don't Know About Corporate Social Responsibility: A Review and Research Agenda. Journal of Management 38 (84): 932-968.
2. Arvidsson, S. (2010). Communication of Corporate Social Responsibility: A Study of the Views of Management Teams in Large Companies. Journal of Business Ethics 96 (2010): 339-354.
3. Azim, M. I., Ahmed, S. and Islam, M. S. (2009). Corporate Social Reporting Practice: Evidence from Listed Companies in Bangladesh 10 (2): 130-145.
4. Bai, X. and Chang, J. (2015). Corporate social responsibility and firm performance: The mediating role of marketing competence and the moderating role of market environment. Asia-Pacific Journal of Management 32 (2): 505-530.
5. Bonson, E. and Bednarova, M. (2015). CSR reporting practices of Eurozone companies. Revista de Contabilidad – Spanish Accounting Review 18 (2): 182-193.
6. Dahlsrud, A. (2006). How Corporate Social Responsibility is Defined: an Analysis of 37 Definitions. Corporate Social Responsibility and Environmental Management 15 (1): 1-13.
7. Dhaliwal, D. S., Li, O. Z., Tsang, A. and Yang, Y. G. (2011).Voluntary Nonfinancial Disclosure and the Cost of Equity Capital: The Initiation of Corporate Social Responsibility Reporting. The Accounting Review 86 (1): 59-100.
8. Du, S., Bhattacharya, C. B. and Sen, S. (2010). Maximizing Business Returns to Corporate Social Responsibility (CSR): The Role of CSR Communication. International Journal of Management Reviews 12 (1): 8-19.
9. Elkington, J. (1998). Cannibals with Forks: The Triple Bottom Line of 21st Century Business. Stony Creek, CT: New Society Publishers.
10. European Commission. (2001). GREEN PAPER: Promoting a European framework for Corporate Social Responsibility. http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2001:0366:FIN:EN:PDF (accessed August 25, 2015).
11. European Commission. (2013). How companies influence our society: Citizens' view. Retrieved from the European Commission website: http://ec.europa.eu/public_opinion/flash/fl_363_en.pdf (accessed September 3, 2015)
12. European Commission. (2014). Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.
13. Freeman, R. E. (1984). Strategic management: A stakeholder approach. Boston: Pitman Publishing.
14. Friedman, M. (1962). Capitalism and freedom. Chicago: University of Chicago Press.
15. Gao, Y. (2011). CSR in an emerging country: a content analysis of CSR reports of listed companies. Baltic Journal of Management 6 (2): 263-291.

16. Global reporting initiative. (2015). Retrieved 14.12.2015. from https://www.global reporting.org.
17. Golob, U. and Bartlett, J. L. (2007). Communicating about corporate social responsibility: A comparative study of CSR reporting in Australia and Slovenia 33 (2007): 1-9.
18. Gori, E., Romolini, A. and Fissi, S. (2012). Social Accountability in Italian Listed Companies: Communication or Voluntary Disclosure? 11 (6): 779-795.
19. Graves, S. B. and Waddock S. A. (2000). Beyond built to last...: Stakeholder Relations in "Built-to-Last" Companies. Business and Society Review 105 (4): 393-418.
20. Grudić Kvasić, S. (2014). Croatian Companies' Corporate Social Responsibility Programs: Content Analysis. Ekonomska misao i praksa 23 (1): 85-104.
21. Guthrie, J. and Parker, L. D. (1989). Corporate Social Reporting: A Rebuttal of Legitimacy Theory. Accounting and Business Research 19 (76): 343-352.
22. Habek, P. and Wolniak, R. (2015). Assessing the quality of corporate social responsibility reports: the case of reporting practices in selected European Union member states. Quality and Quantity: International Journal of Methodology. Retrieved 02.09.2015. from http://www.wbcsd.org/pages/edocument/edocumentdetails.aspx?id=82&nosearchcontextkey=true
23. Ioannou, I. and Serafeim, G. (2014). The Consequences of Mandatory Corporate Sustainability Reporting: Evidence from Four Countries. Harvard Business School Research Working Paper 11-100. Retrieved 4.9.2015. from http://dx.doi.org/10.2139/ssrn.1799589
24. Ismail, F.O., Adegbemi, O. (2013). Does Corporate Social Responsibility Improve Financial Performance of Nigerian Firms? Empirical Evidence from Triangulation Analysis. Acta Universitatis Danubius Œconomica 9 (3): 22-36.
25. Kolk, A. (2008). Sustainability, accountability and corporate governance: exploring multinationals' reporting practices. Business Strategy and the Environment 17(1): 1-15.
26. Kotonen, U. (2009). Formal corporate social responsibility reporting in Finnish listed companies. Journal of Applied Accounting Research 10 (3): 176-207.
27. KPMG. (2015). Currents of change: The KPMG Survey of Corporate Responsibility Reporting 2015. Retrieved 4.9.2015. from https://home.kpmg.com/au/en/home/insights/2015/11/corporate-responsibility-reporting-survey-2015.html.
28. Luo, X. and Bhattacharya, C. B. (2006). Corporate social responsibility, customer satisfaction and market value. Journal of Marketing 70 (4): 1-18.
29. Marfo, E. O., Chen, L. and Xuhua, H. (2015). International Journal of Academic Research in Business and Social Sciences 5 (8): 313-331.
30. Pekanov Starčević, D., Mijoč, I., and Mijoč, J. (2016). Does it pay off to be socially responsible? Empirical and accounting evidence from listed companies. Ekonomski pregled 67 (4): 283-305.
31. Pekanov Starčević, D., Mijoč, J. and Čuljak, M. (2016). Corporate Social Responsibility Disclosure: The Case of Croatian Companies. Paper presented at the 16th International Conference on Economic and Social Development – The Legal Challenges of Modern World, Split.
32. Peršić, M, Bakija, K. and Vlašić, D. (2015). Corporate social responsibility reporting in accordance with the new EU legislation – are Croatian hotel companies ready for it? ToSEE – Tourism in Southern and Eastern Europe 3 (2015): 295-308.

33. Roca, L. C. and Searcy, C. (2012). An analysis of indicators disclosed in corporate sustainability reports. Journal of Cleaner Production 20 (2012): 103-118.
34. Romolini, A., Fissi, S. and Gori, E. (2012). Scoring CSR Reporting in Listed Companies – Evidence from Italian Best Practices. Corporate Social Responsibility and Environmental Management 21 (2): 65-81.
35. Serenko, A. and Bontis, N. (2009). A citation-based ranking of the business ethics scholarly journals. International Journal of Business Governance and Ethics 4 (4): 390-399.
36. Sun, L. (2012). Further evidence on the association between corporate social responsibility and financial performance. International Journal of Law and Management 54 (6): 472-484.
37. Szczepankiewicz, E. I. and Mućko, P. (2016). CSR Reporting Practices of Polish Energy and Mining Companies. Sustainability 8 (2): 126.
38. Turkish Confederation of Employer Associations 2013. Corporate social responsibility for all: Draft review report_CSF for all_Croatia. Retrieved 25.8.2015. from http://csrforall.eu/en/icerik/reports/Croatia-National-Review-Report.pdf.
39. Vitezić, N., Vuko, T. and Morec, B. (2012). Does Financial Performance Have an Impact on Corporate Sustainability and CSR Disclosure - a Case of Croatian Companies. Journal of Business Management 5 (2012): 40-47.
40. Wood, D. J. (2010). Measuring corporate social performance: A review. International Journal of Management Reviews 12 (1): 50-84.
41. World Business Council for Sustainable Development. (1999). Corporate Social Responsibility: Meeting Changing Expectations. Retrieved from World Business Council for Sustainable Development. Retrieved 5.9.2015. from http://old.wbcsd.org/pages /edocument/edocumentdetails.aspx?id=82&nosearchcontextkey=true.

BREXIT – AN UK STATE FINANCE AND TRADE PERSPECTIVE

Jelena Vidovic
University Department of Professional Studies, Croatia
jvidovic@oss.unist.hr

Jasenka Bubic
University Department of Professional Studies, Croatia
jbubic@oss.unist.hr

ABSTRACT

Away from a vast political debate, Brexit has many other financial and trade aspects that need closer attention. In this paper we observe trade between member states, their trade with the rest of the world, trade in goods vs. trade in services, GDP of member states, trade balance, contribution of member states to the EU budget, and willingness of UK to follow agreed changes in tax system. The imposed tax rules that arrive from EU are in UK observed as intrusion in sovereignty to impose taxes. This paper deals with structure of export and import of member states with special emphasis on trade between member states and trade with the rest of the world. If we observe trade through two categories; trade in goods and trade in services, we can conclude that UK trade in relative terms does not primarily depend on trade with member states what cannot be concluded for other member states. In situation when UK does not depend primarily on the trade with EU, is it reasonable to expect that it will continue to contribute to the EU budget and in the same time allow EU legislations to dictate the VAT rates and generally the model in which the taxes should be collected? Another important issue is retained contribution to the EU budget. What kind of effect does the retained EU budget contribution has on UK government finance since UK struggles with budget deficit and trade deficit.

Keywords: *UK, Brexit, EU, trade, budget*

1. INTRODUCTION

UK Government has 12 guiding principles while leaving the EU. White paper which contains Government's stance on the upcoming negotiations has a significant name „The United Kingdom's exit from and new partnership with the European Union". The very title of the document which guides UK form EU says two major things: yes, UK is leaving EU and two; UK needs to continue its partnership with EU. It is very clear that UK will continue to preserve close cooperation with EU relating areas of its interest. The White paper does not provide details relating negotiations with EU in order to escape undermining of its negotiation position. This paper deals with financial aspects of Brexit giving insight into UK`s financial position, primarily overview of its trade and state budget. The paper is organized as follows; in section two we discuss the term Brexit from the UK standing point, in the section three relations between UK and EU state budget are analyised. In the fourth part of the paper we bring insight into UK` trading position with EU and rest of the world and in the last part of the paper we bring conclusions.

2. BREXIT FROM UK STAND POINT

On 17 January 2017 the Prime Minister set out the 12 principles which will guide the Government in fulfilling the democratic will of the people of the UK. These are: 1. Providing certainty and clarity; 2. Taking control of our own laws; 3. Strengthening the Union; 4. Protecting our strong historic ties with Ireland and maintaining the Common Travel Area; 5. Controlling immigration; 6. Securing rights for EU nationals in the UK and UK nationals in

the EU; 7. Protecting workers' rights; 8. Ensuring free trade with European markets; 9. Securing new trade agreements with other countries; 10. Ensuring the United Kingdom remains the best place for science and innovation; 11. Cooperating in the fight against crime and terrorism; and 12. Delivering a smooth, orderly exit from the EU.[1]

As it can be seen process of leaving EU requires a lot of effort in providing legal certainty for business. It is necessary to preserve EU law before leaving EU and afterwards deciding which elements of that law to keep, amend or repeal after Brexit. This allows businesses to continue trading in the knowledge that the rules will not change significantly overnight and provides fairness to individuals whose rights and obligations will not be subject to sudden change.[2] The sovereignty of Parliament is a fundamental principle of the UK constitution, leaving the EU means that all laws will be made in UK and will ensure that domestic legislatures and courts will be the final decision makers in UK. Brexit is also seen as an opportunity to strengthen trade within the UK. For example, Scotland's exports to the rest of the UK are estimated to be four times greater than those to the EU27 (in 2015, £49.8 billion compared with £12.3 billion)[3]. Leaving EU will ensure that there are no new barriers to living and doing business within UK. Besides trade within UK much attention is given to political and economical ties with Ireland and maintaining everyday movements with Ireland when UK leaves EU. UK doubts in its own ability to control immigration when there is unlimited free movement of people to the UK from the EU. Immigration is wanted but preferably from EU countries, and especially high-skilled immigration.

When observing UK`s trade with EU, UK has ambitious plan to conclude Free Trade Agreement with EU and new customs agreement. With the exception of trade with Ireland, the UK's trade balance with other EU Member States is close to zero or negative. The UK imports more from the largest Member States than the UK exports to them.[4] United States is UK's single biggest export market on a country-by-country basis. Trade with EU is one of the crucial topics of Brexit. UK is hoping to maintain trade with EU hoping that trade agreement may take in elements of current Single Market arrangements in certain areas »as it makes no sense to start again from scratch when the UK and the remaining Member States have adhered to the same rules for so many years[5]«. Services sectors are a large and export-rich part of the UK economy. The Single Market for services is not complete. It seeks to remove barriers to businesses wanting to provide services across borders, or to establish a company in another EU Member State, through a range of horizontal and sector-specific legislation. UK will be aiming for the freest possible trade in services between the UK and EU Member States. With the exception of trade with Ireland, the UK's trade balance with other EU Member States is close to zero or negative.
The UK is a global leader in a range of activities, including complex insurance, wholesale markets and investment banking, the provision of market infrastructure, asset management and FinTech. UK is recognized as global financial center. Financial sector is highly integrated sector due to interest of preservation of financial stability and security.

[1] *The United Kingdom's exit from and new partnership with the European Union*. (2017). HM Government. Retrieved 15.05.2017. from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf, p. 5- 6
[2] Ibidem, p. 9
[3] Ibidem, p. 19
[4] Ibidem, p. 36
[5] Ibidem, p. 35

This is why UK does not expect significant socks to services sector which is the strongest part of its economy.

3. BREXIT AND EU BUDGET

One of the largest problems that troubles UK regarding its membership in EU are as they call them in White paper and as Preminister Theresa May names them in her speech[6], vast[7] contributions to the EU budget. The UK provides approximately 12% of the resources available to the EU budget, and is also a significant net contributor[8]. As a member of the European Union the UK makes payments, or contributions, to the EU budget. The UK also receives funding, or receipts, from the EU. The EU provides funding for various agricultural, social, economic development and competitiveness programmes. The UK receives a rebate from the EU which is deducted from its contribution. The rebate was introduced, in 1985, to correct for the fact that the UK was making relatively large contributions to the EU budget but receiving relatively little receipts from it. UK benefits less than other EU member states from the main areas of EU spending, namely direct payments to farmers and the structural and rural development funds[9]. The Government has stated that it is open to making payments towards specific programs in order to cement a cooperative future relationship with the EU but there are already demands from the EU, for much wider contributions. UK is interested in paying to remain in Horizon 2020, the EU's research and innovation programme, or any successor programme. The cost of participating in EU programmes will form part of the UK's exit negotiations. [10]

Member states' contributions are largest source of the EU's revenue. Member States contribute through three sources, which are collectively known as 'own resources': customs tariffs and sugar levies, contributions based on a measure of the VAT-base and GNI-based contributions.[11] According to the UK`s interpretation of Article 50 if withdrawal agreement is not reached within two years and Member States, including the UK, are not agreed to extend negotiations, UK will not be obligated to make any contributions to EU budget - „a guillotine". This could produce a whole in EU`s budget and the EU will be forced to find necessary funding among other member states. This kind of scenario could terminate friendly relations between EU and UK and will probably have many political negative side effects. This scenario could terminate UK` hope for a favorable trading agreement with EU. Really serious problem is calculating UK`s „exit bill" - UK's financial commitments at the point of and after leaving the EU. Problem is that there exist two quite different estimations, first is €20 billion and the latter, published a month later is €60 billion[12]

[6] *Brexit and EU budget.* (2017). European Union Committee15th Report of Session 2016–17, House of Lords Library, HL Paper 125. Retrieved 15.05.2017. from https://www.publications.parliament.uk/pa/ld201617/ldselect/ldeucom/125/125.pdf, p. 4.
[7] *The United Kingdom's exit* .., op. cit., p. 49
[8] *Brexit and EU budget..*, op. cit, p. 3.
[9] Browne, J., Johnson, P., Phillips, D. (2016). *The budget of the European Union*, Institute for fiscal studies. Retrieved 17.05.2017. from https://www.ifs.org.uk/uploads/publications/bns/BN181.pdf : a guide, p. 37
[10] Keep, M. (2017). *The UK's contribution to the EU Budget*, House of Commons Library. Retrieved 17.05.2017. from www.parliament.uk/commons-library | intranet.parliament.uk/commons-library | papers@parliament.uk | @commonslibrary, p. 3
[11] Keep, M. (2017). *A guide to the EU budget*, House of Commons Library. Retrieved 17.05.2017. from http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06455#fullreport
[12] *Brexit and the EU budget*, op. cit, p. 4

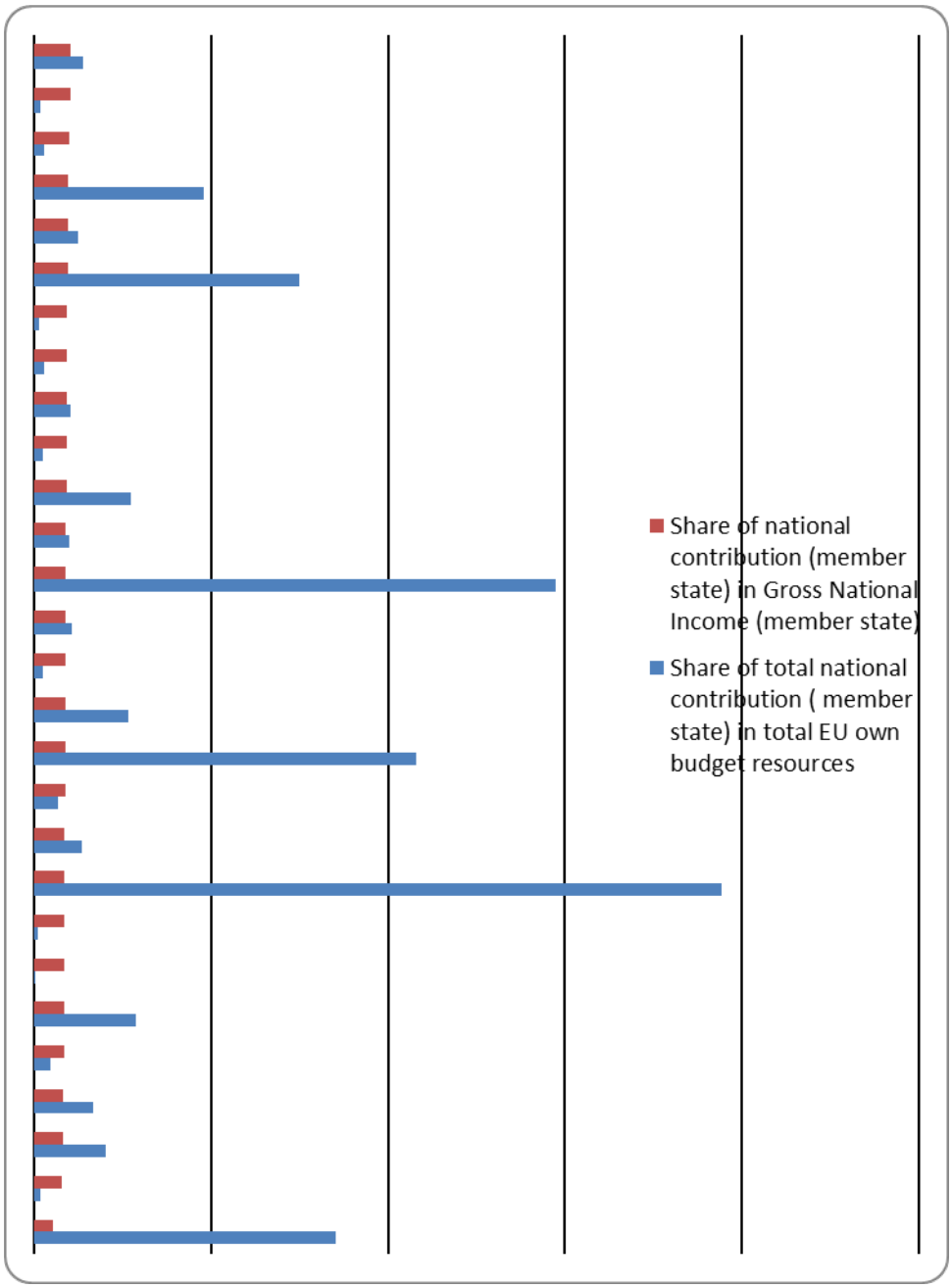


Figure 1: Contributions to EU budget in 2014

Member states in figure 1 are ordered from the member state with largest share of contributions to EU budget own resources relative to its GNI on the top to the state with smallest contributions to EU budget own resources relative to its GNI on the bottom. Source: author calculations based on data from: http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls, population from Eurostat table demo_pjan.

Greatest contributors to the EU budget in 2014 were Germany (19,42%), France, (14,72%), Italy (10,81%), UK (8,53%) and Spain (7,50%). In the observed year UK had the smallest share of contributions to EU budget relative to its GNI (0,52%), followed by Luxembourg (0,79%), Austria (0,82%), Denmark (0,84%) and Slovakia (0,85%).

Table 1: General government deficit/surplus as a percentage of GDP

Geo\time	Germany	France	Italy	United Kingdom
2004	-3,7	-3,5	-3,6	-3,4
2005	-3,4	-3,2	-4,2	-3,3
2006	-1,7	-2,3	-3,6	-2,7
2007	0,2	-2,5	-1,5	-2,9
2008	-0,2	-3,2	-2,7	-4,9
2009	-3,2	-7,2	-5,3	-10,2
2010	-4,2	-6,8	-4,2	-9,6
2011	-1	-5,1	-3,7	-7,6
2012	0	-4,8	-2,9	-8,3
2013	-0,2	-4	-2,7	-5,7
2014	0,3	-4	-3	-5,7
2015	0,7	-3,5	-2,6	-4,3

General government deficit (-) and surplus (+) - annual data as a percentage of gross domestic product (GDP).
Source: http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=teina200

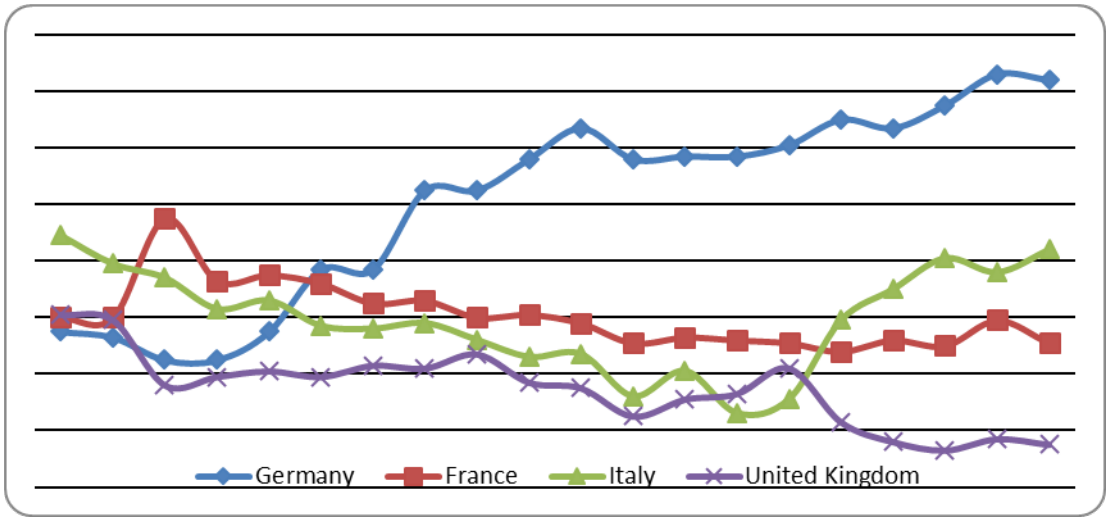


Figure 2: Net lending/borrowing as a percentage of BDP

Net lending/borrowing of a country corresponds to the sum of total current and capital accounts+/- balances in balance of payments. It represents the net resources that the total economy makes available to the rest of the world (if it is positive) or receives from the rest of the world (if it is negative). In another words when the variable is positive (meaning that it shows a financing capacity), it should be called net lending (+); when it is negative (meaning that it shows a borrowing need), it should be called net borrowing . The indicator is expressed in percentage of and calculated as: (CAB+CAK)*100/GDP.
Source: http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tipsbp70

When observing 28 EU member states in 2016, Cyprus had largest deficit on current and capital account (-5,1%), followed by UK (-4,5%), Finland (-1%) and France (-0,9%). Largest capacity for net borrowing as a percentage of GDP is recorded in Germany (8,4%), Netherlands (8,2%) and Denmark (8,1%).

4. GLOBAL TRADING POSITION OF UK

UK politicians, generally have two opposite views of understanding and solving the problem of future trade arrangements of UK. First choice is to stay in the EU which is the world's largest single market; or leaving the EU, which would give opportunity to UK to negotiate its own position. At the moment UK is not interested in trading arrangements which enjoy

Norway and Switzerland. Norway is the member of European Economic Area (EEA) but not a member of EU. Switzerland has a series of bilateral arrangements with the EU.
In exchange for access to the single market, EEA states and Switzerland must pay into the EU budget and adopt a large proportion of EU law—including free movement of people—but they have no say in how those laws are made.

Table 2: Member States' contribution (in %) to the intra-EU28 trade

geo\time	Germany	France	Italy	United Kingdom
2005	22,6	10,6	8,3	8
2006	22,4	10,3	8,2	8,9
2007	23,4	10	8,4	7
2008	22,8	9,8	8	6,5
2009	22,7	9,8	7,7	6,3
2010	22,4	9,4	7,6	6,5
2011	22,3	9,3	7,5	6,5
2012	21,8	9,2	7,5	6,5
2013	21,8	9,2	7,4	6,2
2014	22,1	9	7,5	6,2
2015	22,6	8,7	7,4	6
2016	22,8	8,7	7,5	5,6

Source: http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tet00047

UK is the largest goods export market for the EU27 (Table 3). Exports to the US were £84 billion in 2014, 16% of the total exports. Germany was the second largest export market in 2014 at £45 billion.

Table 3: Top 10 UK trading partners - £ Million

Exports				Imports			
Country	**2012**	**2013**	**2014**	**Country**	**2012**	**2013**	**2014**
United States	83771	92172	84012	Germany	63523	67416	69788
Germany	44785	43371	44922	United States	49217	51192	52151
Netherlands	36388	36176	35989	China	33043	37244	38050
France	32594	32667	30876	Netherlands	35856	41722	37678
Ireland	28862	27447	26919	France	34828	35916	36836
Switzerland	14712	16451	21598	Spain	21826	22473	24033
China	13986	17659	18806	Belgium	20704	22836	23126
Italy	13716	15021	16412	Italy	19114	19591	21283
Belgium	17945	16926	15113	Norway	23198	18732	19619
Spain	14478	13603	14805	Ireland	18180	17712	17086

Source: Office for National Statistics, https://visual.ons.gov.uk/uk-trade-partners/

In 2014 total UK imports form EU28 amounted 274.113.971,36 thousand euro and exports to EU28 amounted 181.878.348,11 thousand euro. UK imports from EU28 was covered with 75,19% of exports in 2014.

Exports in goods traded with non-EU countries (extra-EU trade)[13] in 2014 amounted 198.144.161,02 thousand euro while imports amounted 241.902.880,98 thousand euro.

[13] Extra-EU trade - trade by the EU Member States with non-EU countries, cf., *User guide on European statistics on international trade in goods 2015 edition.* (2015). Eurostat. Retrieved 02.05.2017. from

Position of UK regarding trade with the non-EU countries is slightly better, imports from non – EU countries was covered with exports by 81,91%[14].

Total trade can be broken down into goods and services. The UK has a trade deficit in goods but a surplus in trade with services. Surplus in trade balance in services with the rest of the world is continually growing and in 2016 it amounted 4,69 % of GDP, in the same year credit of trade in services with rest of the world amounted 12,04% of GDP (Table 4). The US is by some way the UK's largest export market if attention is limited to individual countries, rather than trading blocs like the EU.

Table 4: International trade in services (2010-2015)

	Credit million euro	Share in total EU debit in services with rest of the world	Debit million euro	Share in total EU debit in services with rest of the world	Balance
GEO/TIME	Germany				
2010	169.896,0	13,05%	198.788,0	17,45%	-28.892,0
2011	180.200,0	12,88%	212.671,0	17,76%	-32.471,0
2012	196.509,0	13,00%	229.284,0	17,82%	-32.775,0
2013	204.556,0	12,94%	247.780,0	18,41%	-43.223,0
2014	219.722,0	12,91%	255.075,0	17,61%	-35.353,0
2015	238.558,0	12,91%	269.788,0	16,77%	-31.230,0
France					
2010	152.601,0	11,72%	137.161,0	12,04%	15.440,0
2011	169.908,0	12,14%	145.890,0	12,18%	24.018,0
2012	182.625,0	12,08%	157.767,0	12,26%	24.858,0
2013	191.391,0	12,11%	171.776,0	12,77%	19.615,0
2014	207.114,0	12,17%	190.221,0	13,13%	16.894,0
2015	217.774,0	11,78%	208.972,0	12,99%	8.802,0
Italy					
2010	76.234,5	5,85%	85.411,0	7,50%	-9.176,5
2011	79.327,5	5,67%	85.500,1	7,14%	-6.172,6
2012	84.522,6	5,59%	84.645,3	6,58%	-122,7
2013	84.346,5	5,34%	83.868,3	6,23%	478,3
2014	85.899,7	5,05%	86.918,9	6,00%	-1.019,2
2015	88.567,5	4,79%	90.173,0	5,61%	-1.605,5
United Kingdom					
2010	205.447,4	15,78%	135.094,0	11,86%	70.353,4
2011	217.666,0	15,55%	140.083,9	11,70%	77.582,2
2012	243.481,7	16,11%	153.929,7	11,96%	89.552,0
2013	252.941,4	16,00%	157.566,6	11,71%	95.374,8
2014	272.613,3	16,01%	162.034,2	11,19%	110.579,1
2015	310.653,9	16,81%	189.741,5	11,79%	120.912,3

Source: International trade in services (since 2004)
[bop_its_det]http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=bop_its_det&lang=en

http://ec.europa.eu/eurostat/documents/3859598/7027786/KS-GQ-15-010-EN-N.pdf/a1d7bf4b-525e-4183-963c-00cf231650ee, p. 9

[14] *Trade by number of partner countries and NACE Rev. 2*, Eurostat. Retrieved 02.05.2017. from activityhttp://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ext_tec04&lang=en.

EU has trading arrangements with 50+ countries around the world (non-EU) and is negotiating trade arrangement with US.
UK is hoping to negotiate its own trading arrangements and to become a positive and powerful force of free trade. In reality only 11 percent[15] of business in UK export, which means that maximizing exports is not the priority of UK businesses.

European Free Trade Association (EFTA) offers tariff-free trade on goods but -crucially, from a UK perspective - excludes services. Services are the UK`s greatest export industry. UK is currently on the way to leaving the largest free trade market in the world and will be required to negotiate free trade arrangements (FTAs) with the reminder of Europe. UK has not negotiated FTAs on its own behalf for over 40 years, and the question is does it currently possess the knowledge or capacity to manage such a large-scale undertaking. In addition to FTAs, the UK is a party to hundreds of international political agreements between the EU and other states and organizations, these agreements would, in practice probably cease to apply after "Brexit". Member States cannot negotiate their own trade deals. Lisbon Treaty is explicitly stating that the Common Commercial Policy (CCP) falls within the exclusive competence of the EU and that only the EU may legislate and adopt legally binding acts in the areas covered by the CCP.[16]

Table 5: Trade balance of Member States in all products with all countries of the world (in million EURO)

GEO/TIME	Germany	France	Italy	United Kingdom
2007	194.258,5	-51.987,9	-8.595,9	-143.328,5
2008	177.525,5	-68.367,4	-13.034,6	-126.200,0
2009	138.868,3	-56.062,3	-5.875,5	-117.877,1
2010	153.963,8	-65.854,1	-29.982,5	-131.525,9
2011	157.410,6	-88.761,3	-25.523,9	-123.989,9
2012	191.672,4	-82.274,9	9.889,6	-173.123,2
2013	198.655,3	-75.675,2	29.230,4	-89.917,0
2014	216.459,6	-72.361,9	41.931,6	-139.451,2
2015	248.195,7	-60.945,8	41.806,9	-149.811,5
2016	256.526,5	-64.654,8	51.497,8	-204.475,2

Source: Eurostat, International trade of EU, the euro area and the Member States by SITC product group [ext_lt_intertrd], http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ext_lt_intertrd&lang=en

UK continually has trade deficit and it is the largest deficit among member states which give biggest contribution to EU budget (Table 6).

Most interesting trading options for UK are Commonwealth and WTO. Commonwealth[17] has 53 member countries. Developed Commonwealth countries are Australia, Canada, Cyprus, Malta, New Zealand and the UK and some of the world's fastest growing countries. It accounts for more than two billion people and spans six continents. In 2014, total UK exports

[15]*Leaving the EU: Global Free Trade*. (2016). House of Lords Library. Retrieved 17.05.2017. from http://researchbriefings.parliament.uk/ResearchBriefing/Summary/LLN-2016-0053, p. 4
[16]*Review of the Balance of Competences between the United Kingdom and the European Union Trade and Investment* HM Government (2014). Retrieved 17.05.2017. from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279322/bis_14_591_balance_of_competences_review_Trade_and_investment_government_response_to_the_call_for_evidence.pdf, p. 9
[17] The Commonwealth. *Member states*. Retrieved 17.05.2017. from http://thecommonwealth.org/member-countries

to Commonwealth countries were worth £48 billion, approximately 9 percent of the UK's total exports worldwide. Imports from the Commonwealth were £47 billion, also around 9 percent of the UK total imports. [18] In 2015, intra-Commonwealth trade was valued at almost $700 billion[19]. Since 2000, the combined total global exports of goods and services of Commonwealth countries have almost tripled, from $1.3 trillion to $3.4 trillion, accounting for 14.6 per cent of global exports in 2013. Almost half of total Commonwealth exports come from its developed members, comprising Australia, Canada, Cyprus, Malta, New Zealand and the UK. The share of developing countries in the total trade of Commonwealth members has also increased, from 36 per cent in 2000 to just above 50 per cent in 2013[20].

The UK is a founding member of the WTO and has been a member of the General Agreement on Tariffs and Trade since 1948. WTO membership is seen as a bedrock on which UK builds its future trade relationships[21].President Obama and his Administration have made it clear that they would prefer the UK to remain inside the EU, where it is generally seen to promote Atlanticist policies. If the UK can no longer act as a bridge between Brussels and Washington, it is realistic to assume that the US will seek to strengthen its bilateral relationships with EU allies, especially France and Germany[22].

5. CONCLUSION

Does EU needs UK or UK needs EU? The answer is somewhere in the middle, let us say that UK needs EU under its terms and conditions. Anyway what you could other expect from the worlds giant in export of services. It seems like UK wants to use all the pluses of the EU membership and in the same time to avoid any financial obligations and imposed free movement of people resisting in that way to uncontrollable immigration.When all the facts are observed it can be seen that membership in EU brought to UK only negative trade balance and state finance deficit what resulted in borrowing money. UK is one of the largest contributors to EU budget and in the same time this contributions represent smallest proportion of member state`s GNI if we observe all other member states. This resources are from the EU`s point of view significant. Surely there is a large number of projects that UK is interested in and interested to stay involved in these projects but under its own conditions as a non-EU member state. In the same time export of services flourishes and UK is sure in remaining its position as a global financial center. Obviously UK doesn't seem to find financial sector threatened by Brexit. Besides all, UK seems to have structural issues, meaning on small agricultural sector and the fact that UK businesses are not export oriented, while export of service sector is the strongest point of UK`s economy and brings significant trade surpluses. Furthermore, the effect of leaving the EU to the public finances would depend much more on the economic impact of leaving the EU than the amount that could be saved by no longer having to contribute to the EU Budget. Largest UK export trading partners are US and Germany.

[18] UK-*Commonwealth Trade.* (2016). House of Lords Library. Retrieved 17.05.2017. from http://researchbriefings.parliament.uk/ResearchBriefing/Summary/LLN-2016-0043P- I
[19] *Brexit and the EU budget..*, op. cit., p. 18.
[20] *The Commonwealth in the Unfolding Global Trade Landscape: Prospects Priorities Perspectives*. (2015). Commonwealth Trade Review 2015, The Commonwealth. Retrieved 17.05.2017. from http://thecommonwealth.org/sites/default/files/inline/Commonwealth%20Trade%20Review%202015-Full%20Report.pdf, 9. XIX.
[21]*Brexit and the EU budget..*, op. cit., p. 56.
[22]*Committee Implications of the referendum on EU membership for the UK's role in the world.* (2016). Fifth Report of Session 2015–16, House of Commons Foreign Affairs. Retrieved 13.05.2017. from https://www.publications.parliament.uk/pa/cm201516/cmselect/cmfaff/545/545.pdf, p. 27.

UK sees its future trade under WTO and Commonwealth and favorable trade agreement with EU. The worst scenario would be if time shows that Brexit is not well-calculated political decision.

LITERATURE:

1. *Brexit and EU budget.* (2017). European Union Committee15th Report of Session 2016–17, House of Lords Library, HL Paper 125. Retrieved 15.05.2017. from https://www.publications.parliament.uk/pa/ld201617/ldselect/ldeucom/125/125.pdf
2. Browne, J., Johnson, P., Phillips, D. (2016). *The budget of the European Union*, Institute for fiscal studies. Retrieved 17.05.2017. from https://www.ifs.org.uk/uploads/publications/bns/BN181.pdf : a guide
3. *Committee Implications of the referendum on EU membership for the UK's role in the world.* (2016). Fifth Report of Session 2015–16, House of Commons Foreign Affairs. Retrieved 13.05.2017. from https://www.publications.parliament.uk/pa/cm201516/cmselect/cmfaff/545/545.pdf
4. Keep, M. (2017). *A guide to the EU budget*, House of Commons Library. Retrieved 17.05.2017. from http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06455#fullreport
5. Keep, M. (2017). *The UK's contribution to the EU Budget*, House of Commons Library. Retrieved 17.05.2017. from www.parliament.uk/commons-library | intranet.parliament.uk/commons-library | papers@parliament.uk | @commonslibrary
6. *Leaving the EU: Global Free Trade*. (2016). House of Lords Library. Retrieved 17.05.2017. from http://researchbriefings.parliament.uk/ResearchBriefing/Summary/LLN-2016-0053
7. *Review of the Balance of Competences between the United Kingdom and the European Union Trade and Investment* HM Government (2014). Retrieved 17.05.2017. from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279322/bis_14_591_balance_of_competences_review_Trade_and_investment_government_response_to_the_call_for_evidence.pdf
8. *The Commonwealth in the Unfolding Global Trade Landscape: Prospects Priorities Perspectives*. (2015). Commonwealth Trade Review 2015, The Commonwealth. Retrieved 17.05.2017. from http://thecommonwealth.org/sites/default/files/inline/Commonwealth%20Trade%20Review%202015-Full%20Report.pdf
9. The Commonwealth. *Member states*. Retrieved 17.05.2017. from http://thecommonwealth.org/member-countries
10. *The United Kingdom's exit from and new partnership with the European Union*. (2017). HM Government, Retrieved 15.05.2017. from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf
11. UK-*Commonwealth Trade.* (2016). House of Lords Library. Retrieved 17.05.2017. from http://researchbriefings.parliament.uk/ResearchBriefing/Summary/LLN-2016-0043P- I
12. *User guide on European statistics on international trade in goods 2015 edition.* (2015). Eurostat. Retrieved 02.05.2017. from http://ec.europa.eu/eurostat/documents/3859598/7027786/KS-GQ-15-010-EN-N.pdf/a1d7bf4b-525e-4183-963c-00cf231650ee, p. 9

ANALYSIS OF REGIONAL DEVELOPMENT OPPORTUNITIES IN SLOVAK REPUBLIC

Katarina Rentkova
Comenius University in Bratislava, Faculty of Management, Slovakia
katarina.rentkova@fm.uniba.sk

ABSTRACT

Regional policy and regional development has started to develop in the Slovak Republic to the early 90s of the 20th century. Independence of the Slovak Republic had the greatest impact on the implementation of the principles of regional development as well as preparation for accession to the European Union. Slovakia's accession to the European Union has opened new possibilities for utilization of funds earmarked for targeted regional development. Cohesion policy of the European Union acts currently at different stages and area of regional development. Cohesion policy is carried out in three basic levels in Slovakia, namely - national, regional and local level. Achieving desired objectives is possible only if the policy will be properly and effectively implemented at the local level, which requires a positive perception of the municipalities. Municipalities and cities take care of comprehensive development of areas at local level. This follows from the Act no. 369/1990 Coll. on Municipalities, as amended. The role of the creation of sustainable economic, social and territorial development indicates for municipalities of the Act No. 539/2008 Coll. on regional development support, as amended. According to Law no. 369/1990 Coll. on Municipalities, as amended, municipalities must carry out particular tasks and responsibilities related to the management of the municipality and its property and municipalities have to provide a wide range of services to citizens, for example, municipalities must provide services in the areas of supply, health, education, culture, sports, transport, social work, urban planning and promotion of entrepreneurship. As a result of the delegation (the transfer of competencies from the state to municipalities), many responsibilities have been delegated to the municipalities. But the main question remains how municipalities perceive and implement, in addition to the performance of their basic tasks and obligations under the Law on Municipalities, the delegation of responsibilities related to regional development, as they required by law.

Keywords: *cohesion policy, municipality, regional development, Slovak republic.*

1. INTRODUCTION

The Slovak Republic was preparing its regional policy mainly for the possibility of spending pre-accession support. Therefore it tried to revise it substantially. In 2001, the chapter of Regional policy and coordination of structural instrument was open. Within these steps, documents were adopted in order to ensure spending of pre-accession support, as well as from Structural Funds. The Slovak Republic started to spend the pre-accession support from 1990. It was realized through PHARE fund. Funds OSPA and SAPARD were established in 2000. Through the pre-accession support and its financial instruments the preparation and the application of regional policy and its funds were supported. The positive development of regional policy, from the view-point of its legislative definition and amendments occurred without a doubt. However, there are still problems. "*The main problem is that the regional policy, which was realized in the economy of the Slovak Republic in the past, was promoted in the decisive volume through partial and mutually disconnected measures. While meanwhile (since 1998) the regional policy is in the decisive volume influenced from the*

outside and that namely by the requirements which resulted from the pre-accession process to the EU." (Okáli, 2004)

The fundamental problem, upon which Okáli has drawn attention stems from the principle of creation of regional policy. Throughout the first years of transformation of economy we observe the absence of any conception of regional development. The whole principle of its creation was built on the creation of regional policy which would satisfy the conditions of European Union in order for the pre-accession and at a later time for the structural and cohesion support to be spent preferentially. This principle is noticeable in all of the adopted documents acting within the regional policy. Our analyzed period starts with the accession on the Slovak Republic in the European Union and continues to be effective in the present as well.

2. RESEARCH OBJECTIVE

The main objective of the research article is to analyze regional development, in the context of an analysis of the implementation regional development policy in the Slovak Republic. The secondary goal includes detection and consideration of the opportunities for local development represents by the municipalities in the Slovak Republic.

3. METHODS AND METHODOLOGY

The cohesion policy has its importance. In the Slovak republic, it is possible to observe the results of its application. It creates many synergic effects and therefore it necessitates the management approach of its administration and realization. The research was processed by using a wide scale of the scientific methods. The specific range of methods was based on the research needs of the individual parts. We analyzed scientific publications and papers by various authors, statistics. The fact that regional development in the Slovak Republic is the basis of many research can be seen on the basis of analysis of authors' like Cihelková (2007,2010); Čadil (2010), Jáč (2010), Janać and Roštárová (2016, 2014), Komorník Majerčáková (2015), Majerčáková (2015), Mittelman – Majerčáková and Gasperová (2016), Pawera and Stachová (2011), Šlahor and Kocher (2013) or Šlahor – Majerčáková and Barteková (2016). Information obtained were screened, selected, verified. They were made of their discussion, comparison. Subsequently by means of mathematical and statistical tools were processed to be easy evaluate. According to the findings, it could be said that Slovakia uses funds from the perspective of a separate pumping efficiently, but whether this indicator is sufficient for evaluation is questionable, because the elimination of regional disparities by using of structural funds is also not significant.

4. THEORETICAL BACKGROUND

Cihelková (2007) defines the region on the basis of regionalization, the definitions are based on analyzes of several economists. Regionalization represents *"different, private and public forms of social and economic association and cooperation within a certain area."* Using this definition, we can say that the term region means through regionalization a territorial unit/area that is analyzed through the entities established therein. There are some specific relations between these entities that can be further analyzed using the regional economy. The region cannot be defined only in the geographical sense. It is determined by its spatial dimension, which is complemented by specific features in terms of its size, structure or administrative structure. Čadil (2010) defined the term region in the context of regionalization, too. The author admits that the term region can be defined from:

- an administrative definition - as a territory or an administrative unit characterized by certain characteristics common to other territories. *"Administrative regions divide the*

territory of the state. There are hierarchical links (subordination and superiority) between the areas of management of administrative activity." (Jáč, 2015) A characteristic feature, according to the administrative definition are GDP per capita, unemployment rate, concentration of industry.

- a functional definition – *"is based on the pursuit of economic ties between the entities (agents) in the area and it sets the region as an area where there are intensive ties between agents within the region and significantly less intense, outside this region."* (Čadil, 2015) From this point of view of the definition of the region we can say that it will be more effective to monitor the intensity of interconnections between different areas. Čadil (2015) is based on the determination of the functional region from the terminology defined by Hoover and Giarratani (1999).

It is clear that the region can be defined from a geographical point of view, in terms of its functionality, according to its purpose, the consistency of activities carried out in the region, its economic performance, both in terms of legislative definition and in terms of the European Union itself. The valid Slovak legislation is based on Act No. 539/2008 Coll. on regional development support, as amended. The definition of the region is included in § 2, a). By this law, a region is defined as a *"territorial unit defined according to the classification of statistical territorial units."* Slovak legislation refers to the Decree of the Statistical Office of the Slovak Republic No. 438/2004 Coll. The valid version gives the classification of statistical territorial units, dated from July 19, 2004. From the point of view of scientific research, there are many types of regions. If we analyze the region from the point of view of spatial economics, we consider as important to mention Jovanovic's (in: Cihelková, 2007) definition, which defines the region as a *"clearly defined geographic unit that has its political, governmental and administrative, ethnic, social, human and cultural dimensions."* Cihelkova (2007) extended its definition by level of economic analysis. According to Cihelkova (2007), we are focusing the region's analysis on specific indicators such as region's production factor, availability and mobility. From the point of view of the regional economy, the region remains an open economy.

Given the growing globalization and the use of regional integration clusters, Cohesion Policy has a major impact on regional development. It can bring together the need for joint action for regional development through regional development instruments.

OECD definition of regional development says that *"regional development is a broad term but can be seen as a general effort to reduce regional disparities by supporting (employment and wealth-generating) economic activities in regions. In the past, regional development policy tended to try to achieve these objectives by means of large-scale infrastructure development and by attracting inward investment."* In the Slovak Republic, regional development is defined by the Law no. 539/2008 Coll. on regional development support, as amended, as *"a set of social, economic, cultural and environmental processes and relationships that take place in the region and contribute to improving its competitiveness, sustainable economic development, social development and territorial development and to reducing economic disparities and social disparities between regions."*

The main objective of the regional development maintenance is to eliminate or to soften undesirable differences on the level of the economic, social and territorial regional development and therefore to increase the economic efficiency, competitiveness and the

development of innovations, to increase the employment and the living standards of the inhabitants in the regions while maintaining the sustainable growth. The last important change of the cohesion policy specification was amended by the Treaty of Lisbon. The Treaty of Lisbon comprised a lot of changes in the European system and amended the policy itself as well. From the moment it entered into force, we can really discuss the cohesion policy. From the moment of defining the regional policy in Single European Act, the policy reinforcement affected the area of economic cohesion and social cohesion. By the Treaty, but also by the new strategy Europe 2020, the new dimension is established. The article 3 of the consolidated version of the Treaty on European Union recognizes that EU "*shall promote economic, social and territorial cohesion and solidarity among Member States*".

The municipality has the status of a separate political and legal entity with a legal personality, it is a self-employed with the income and of its own assets and is based on European Charter on Local Self-Government. According to Kováčová (2010), the main task of the municipal government is caring for the overall development of the municipality that satisfy the interests and needs of its inhabitants. Municipalities, in the exercise of local government, can be imposed role merely by the law. Municipalities carry out tasks in its competence, we call them the original competences. Tasks resulting from the Act. 369/1190 Coll. on Municipalities, as amended. Municipalities financed original competences from own resources. Municipalities also carry out tasks in devolved powers, the state managed and controlled them. Competence in devolved powers passed on to municipal governments in the years 2002 - 2004 in accordance with Act no. 416/2001 Coll. the transfer of some competencies from state administration to municipalities and higher territorial units, as amended. Exercise of these transferred competencies is financed by the State through subsidies from the state budget. (Hamalová, 2014) Act No.539/2008 Coll. on regional development support, as amended, specifies that the main documents of regional development are - National Strategy of Regional Development of the Slovak Republic, the development program of higher territorial unit of the village development program, a joint program of municipal development. Municipal development program is a development document that is being executed at the regional and local levels in accordance with that law. Based on analysis of §5-§8a we can determine the hierarchical superiority of individual documents. Figure 1 shows the extent of the planned strategy of regional development at various stages.

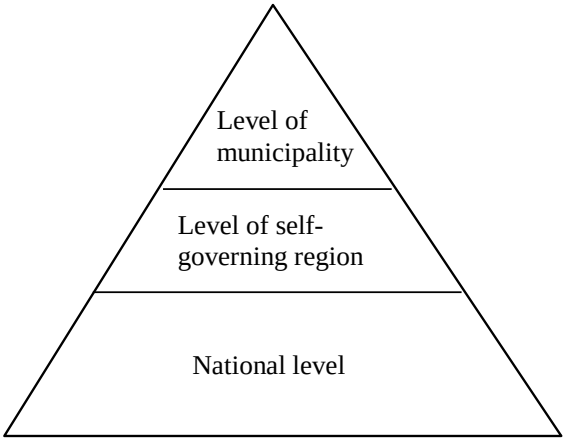


Figure 1: Level of regional development due the Act No. 539/2008 Coll, on regional development support, as amended. *(Processed by the author)*

Regional policy is applied at three levels in the Slovak Republic:

- Central / national level - the relevant central government authorities guarantee its performance. This level is more selective, focusing on pre-defined regions.
- Regional level - power is provided through the Higher Territorial Units (NUTS 2 classification of regions), with nationwide coverage. Its orientation is on intra-regional issues (focuses on municipalities, micro-regions, and districts), cooperation between regions and cross-border cooperation.
- The regional / local level - implementation is ensured through the village. The municipality area is smaller than the region, i.e. only part of the reference region in the context of regional policy

5. RESULTS

Cohesion policy is characterized by several specificities that are defined in European Union legislation. The funding package, from the European Union budget, is earmarked for 7 years. The objectives must be set, the tools identified and the policy implementation principles adopted in order that the policy can be implemented at national, regional and local levels. After the adoption of the Slovak Republic as a member of the European Union on 1 May 2004, the Slovak Republic was given the opportunity to participate in the creation of the Financial Policy of the European Union and fully exploit the opportunities of membership in the context of regional development. The policy was implemented through multi-annual financial frameworks, i.e. seven-year funding plans. Every year, the Council and Parliament approve the European Union's budget for the following year. The Slovak Republic worked in two multiannual financial periods during its membership in the European Union, the programming periods are already completed. The Slovak Republic is currently working in a third period. If we analyze periods in terms of cohesion policy, i.e. regional development, we can talk about the 2004-2006 programming period and the 2007-2013 programming period. Revenues for the Slovak Republic from the budget of the European Union and payments to the EU budget in the programming period 2004-2006 and programming period 2007-2013 are illustrated in the Table 1 and Table 3.

Table 1, in mil. Eur: Revenues of the Slovak Republic from the budget of the European Union and payments to the budget of the European Union in 2004 – 2006 *(Ministry of Finance of the Slovak Republic)*

Year	Revenues for the Slovak Republic from the EU budget	Payments of the Slovak Republic to the EU budget and extra-budgetary programs	The net financial position of the Slovak Republic to the EU budget
2004	303.99	290.289	13.301
2005	704.993	485.614	219.379
2006	893.623	526.326	367.297
Sum	1,902.606	1,302.229	599.977

The National Plan of Regional Development of the Slovak Republic (hereinafter “NPRD SR”) was the basic document determining the development of Slovakia in the 2004-2006

programming period. For the period 2004-2006, the Slovak Republic had a strategic goal of ensuring GDP growth in the face of sustainable development so that the Slovak Republic could reach 54% of GDP per capita in the EU15 by 2006. This objective should be achieved by supporting: economic growth and competitiveness, employment and balanced regional development. Four specific objectives and four priorities have been defined.
Objectives were:

- Increasing the competitiveness of industry and services;
- Development of human resources and improvement of their adaptability;
- Increasing efficiency in the agricultural production sector and the quality of life of the rural population;
- Promoting of balanced regional development.

Priorites were:

- Competitiveness;
- Employment;
- Agriculture and regional development;
- Basic infrastructure.

Table 2, in mil. Eur: Summary information on projects implemented in regions of the Slovak Republic 2004- 2006 *(ITMS,2014)*

	Bratislava region	**Western Slovakia**	**Central Slovakia**	**Eastern Slovakia**	**Average values found**
Total number of projects received	1761	4101	3159	3537	3139,5
Total number of projects implemented	507	1263	890	986	799
Funds drawn from sources of Structural Funds and State Budget in mil. SKK	881,268,837	4,787,855,683	6,349,429,665	3,727,366,225	3,936,480,103
The average amount of one realized project, in SKK	1,738,203	3,811,987,009	7,134,191	3,780,291	**4,926,759**

The National Strategic Reference Framework of the Slovak Republic (hereinafter "NSRF SR") was the basic strategic document in which the regional development of the Slovak Republic was planned for the 2007-2013 programming period.
The document was based on the main objectives of the European Union and was designed to support as much as possible their achievement while creating the space for the development

of the Slovak Republic. NSRF SR obtained three main objectives: Convergence, Regional Competitiveness and Employment and European Territorial Cooperation. The main objective of Slovakia's development was to: Significantly increase the competitiveness and performance of the regions and the Slovak economy by 2013, and employment in respect of sustainable development. Three specific objectives and three priorities have been defined.

Objectives were:

- Infrastructure and regional accessibility;
- Knowledge Economy;
- Human resources.

Priorites were:

- Increasing infrastructure density in infrastructure and increasing the efficiency of public services.
- Development of the sustainable economic growth and increasing the competitiveness of industry and services.
- Increasing employment, increasing the quality of the workforce for the needs of a knowledge-based economy and increasing the social inclusion of risk groups.

In the programming period 2007 - 2013, 23 525 projects were submitted together. 13,226 projects were rejected and only 9878 approved. The remaining 421 could not be included. As a result, almost 56.33% of projects are rejected and only 41.99% of projects are approved. Approval was carried out in stages and levels, according to the assessment of the four criteria. Applicants need to know the process of requesting funds from the Structural Funds, as well as the evaluation criteria and the current situation in the Slovak Republic. With regard to good information and project education, it is possible to create beneficial projects for the whole country. This can be avoided by frequent rejections and, where appropriate, by a total failure to use of Structural Funds.

Table 3, in mil. Eur: Revenues of the Slovak Republic from the budget of the European Union and payments to the budget of the European Union in 2007 – 2013 *(Ministry of Finance of the Slovak Republic)*

Year	Revenues for the Slovak Republic from the EU budget	Payments of the Slovak Republic to the EU budget and extra-budgetary programs	The net financial position of the Slovak Republic to the EU budget
2007	910.838	589.800	321.038
2008	893.497	643.374	250.123
2009	1,119.659	695.726	423.933
2010	1,672.483	627.529	1,044.954
2011	2,041.093	704.656	1,336.437
2012	2,137.849	722.831	1,415.018
2013	2,185.358	831.098	1,360.260
Sum	10,960.777	4,815.014	6,151.763

6. CONCLUSION

The realization of the cohesion policy represents a complicated process that comprises of many subjects and objects which create, implement, monitor, evaluate and execute the policy. To the highest extent, the financial inputs come into this process from the EU funds. According to the adopted intents and objectives of the cohesion policy, the output is represented by the decrease of the regional disparities. The base is represented by the strategic, financial and legislative determination of the policy as well as by the creation of conditions for the applicants demanding irreclaimable financial grant. Only in the case of good setup and application of the basic criterions, the policy could be effectively realized.

The Slovak Republic has been a member of the European Union for 13 years. In 2009, she became a member of the Eurozone and started to use the Euro single currency. It has gained many responsibilities and worries, but also benefits. The Slovak Republic and its regions have been given the opportunity to develop their potential and make use of the Structural Funds so as to maximize the awareness of the country. It is up to us to tackle this problem and whether we will really be able to implement our plans and develop regional policy through the use of structural funds as well.

LITERATURE:

1. Act No. 539/2008 Coll. on the regional development support as amended.
2. Act No. 37/2010 Coll. to amend Act No. 575/2001 Coll. on organization of activities of the Government and central state administration bodies as amended.
3. Cihelková, E. a kol. (2007). *Nový regionalismus – teorie a případová studie (Evropská unie)*. Praha: C. H. Beck.
4. Cihelková, E. a kol. (2010). *Regionalismus a multilateralismus – základy nového světového obchodního řádu?* Praha: C. H. Beck.
5. Čadil, J. (2010). *Regionální ekonomie. Teorie a aplikace*. Praha: C. H. Beck.
6. Consolidated version of the Treaty on European Union and the Treaty on the functioning of the European Union signed in Lisbon, 13 December 2007. Official Journal of the European Union, C 83 of 30 March 2010. ISSN 1725-5236
7. Jáč, I. a kol. (2010). *Jedinečnost obce v regionu*. Praha: Professional Publishing.
8. Janać, J., Roštárová, M. (2016). *Start-up enterprises in the world of globalization*. Žilina: University of Žilina.
9. Komorník, J., Majerčáková, D. (2015). *Úvod do finančného manažmentu*. Bratislava: Kartprint.
10. Majerčáková, D. (2015) *The impact of social enterprises in the terms of social innovations*. In: Innovation management and sustainable economic competitive advantage: from regional development to global growth. p. 1585-1593. Norristown: IBIMA.
11. Ministry of Finance of the Slovak Republic. *Structural Funds*. Retrieved from http://www.finance.gov.sk/Default.aspx?CatID=6238
12. Mittelman, A., Majerčáková, D., Gasperová, J. (2016). *Impact investment as a potential for Slovak banking sector*. Norristown, PA: IBIMA.
13. Okáli, I. a kol. (2004). *Hospodárska politika Európskej únie a Slovenska v EÚ*. Bratislava: Ústav slovenskej a svetovej ekonomiky Slovenskej akadémie vied.
14. Pawera, R., Stachová, P. (2011). *Dopady prítomnosti diskriminácie na slovenskom trhu práce na rozvoj regiónov*. In: Zimný seminár regionálnej vedy. - Bratislava : Spoločnosť pre regionálnu vedu a politiku.
15. Rentková, K. (2009). *Aplikácia regionálnej politiky Európskej únie v Slovenskej republike*. In: Trendy v manažmente očami mladých vedeckých pracovníkov. Zborník z vedeckej konferencie doktorandov FMUK v Bratislave. Bratislava: KARTPRINT.

16. Rentková, K. (2011). *Regionálna ekonomická politika Európskej únie v podmienkach Slovenskej republiky*. In: Sborník příspěvků IV. Medzinárodní vědecké konference doktorandů a mladých vědeckých praxovníků Karviná 4.november 2011. Karviná: Slezká univerzita v Opavě, Obchodně podnikatelská fakulta v Karviné.
17. Rentková, K. (2012). *Obec v lokálnej regionálnej politike*. In: Zborník z vedeckej konferencie doktorandov a mladých vedeckých pracovníkov FMUK konanej 10.novembra 2011. Bratislava.
18. Roštárová, M., Janác, J. (2014). *Analýza podnikateľského prostredia v Srbsku*. In: Horizonty podnikateľského prostredia, Bratislava: Univerzita Komenského v Bratislave.
19. Šlahor, Ľ., Majerčáková, D., Barteková, M. (2016). *Implications of Low/Negative interest rates for banks asset and liability management - An example*. Proceedings of 13th International scientific conference European financial systems 2016 Brno, Masaryk University, Czech Republic.
20. Šlahor, Ľ., Kocher, K. (2013). *Aspects of management - an analysis of operational risks of a commercial bank under public law in due consideration of theoretical and institutional foundations.* Bratislava: Univerzita Komenského v Bratislave.
21. Treaty of Lisbon, amending the Treaty on European Union and the Treaty on the functioning of the European Union signed in Lisbon 13 December 2007.
22. Výrostová, E. (2010). *Regionálna ekonomika a rozvoj*. Bratislava: IURA Edition, spol. s r.o.

GEOPOLITICAL AND GEOECONOMIC DIMENSIONS OF THE SHANGHAI COOPERATION ORGANIZATION. THE EUROPEAN UNION AND THE EURASIAN ECONOMIC UNION PERSPECTIVE

Katarzyna Czerewacz-Filipowicz
Bialystok University of Technology, POLAND
k.czerewacz@pb.edu.pl / czerewacz.k@gmail.com

ABSTRACT

The popularity of the Shanghai Cooperation Organization (SCO) has been increasing in recent years. The SCO, as a geopolitical frame of reference, has become attractive to many countries in Asia and Europe. Apart from the countries that have cooperated with the organization for many years (eg. India, Pakistan, Iran, Afghanistan), the SCO has begun to attract new entities, an example of which is Turkey (Republic of Turkey Ministry of Foreign Affairs, 2016; Wang, 2016; The American Interests, 2016). Unexpectedly, geopolitical and economic problems that affect Europe and Asia now, such as war in Syria, an armed conflict in Ukraine, a wave of terrorism, migration crisis, resulted in a departure from the functioning Euro-Atlantic and European solutions. Particular countries seeking stability, economic (eg. Tajikistan, Kyrgyzstan) and/or political (Turkey) security are turning to the Shanghai Cooperation Organization. A reorganization of the international order is taking place. Therefore, the objective of this study is to specify the scope and nature of possible ramifications brought by the activities of the SCO. The viewpoint adopted by the author relates mainly to the European Union and the Eurasian Economic Union perspective, but certainly because of the potential of the Member States, the Shanghai Cooperation Organization can change the appearance of the modern world. The question is whether or not the increase in the attractiveness of the concept of the Shanghai Cooperation Organization and other initiatives of China and Russia means that "soft power" of the EU is getting weaker and weaker, like it was in the case of the USA in the 1990s of the twentieth century (Nye, 2004). Democratic ideals having been promoted by Europe are not attractive to autocratic regimes, while they can perceive the SCO as a support instrument (Vinokurov and Libman, 2012, p.59).

Keywords: *Eurasian Economic Union (EAEU), European Union (EU), Regional Integration Agreements (RIAs), international trade, Shanghai Cooperation Organization (SCO)*

1. INTRODUCTION

Originally, there was no indication that the Shanghai Five grouping established in 1996 would mark the beginnings of an influential international organization. The main causes of establishing the Shangai Five was in fact a sense of danger in the central-Asian region in the early 1990s and the problem of unsettled borders of Kazakhstan, Kyrgyzstan and Tajikistan with China (Sikora-Gaca, 2015, pp. 197-198). The border problems that were a legacy of the Soviet Union led to the escalation of the conflict and a concentration of the Chinese troops on the border with Kazakhstan. A remedy for this was to be the *Agreement on Confidence Building in the Military Field in the Border Area* signed on 26 April 1996 by China, Russia, Kazakhstan, Kyrgyzstan and Tajikistan, constituting at the same time the Shanghai Five. The subsequent summits in 1997 in Moscow and 1999 in Kyrgyzstan deepened the cooperation especially in the areas of regional cooperation in a fight against terrorism, illegal immigration control and a fight against drug trafficking, maintaining the area of Central Asia as a zone free of nuclear weapons and promoting the idea of a multipolar world and a counterbalance to the US dominance. The first years of the structure operation did not bode well for it because

of a serious credibility breach in relation to the so-called Batken crises. The turning point of the cooperation within the Shanghai Five was the summit in 2001 during which *The Declaration on the Establishment of the Shanghai Cooperation Organization* was signed (June 15, 2001) by the current members and Uzbekistan, which had just obtained membership in the Shanghai group (Olędzki, 2016). This declaration took on the policy nature and defined the objectives and tasks of the SCO. The summit in Shanghai also adopted the document *The Shanghai Convention on Combating Terrorism, Separatism and Extremism* (2001), which was the reflection of a fight against the "three evils" plaguing the region of Central Asia. The next stage of the construction of the organization was the adoption of *The Charter of the Shanghai Cooperation Organization* on 7 June 2002, which regulated institutional issues of the organization, defined its objectives and tasks, determined the directions of further development and defined a way of creating its budget (Wańczyk, 2016) and making an *Agreement Between the member states of the Shanghai Cooperation Organization on the Regional Anti-Terrorist Structure*, June 7, 2002. The legal bases for the operation of the SCO were supplemented in subsequent years by an *Agreement on the Database of the Regional Anti-Terrorist Structure of the Shanghai Cooperation Organization* -June 28, 2004, a *Concept of Cooperation Between the SCO Member States in Combating Terrorism, Separatism, and Extremism*-June 5, 2005 and *Protocol on Amendments to the Agreement Between member states of the Shanghai Cooperation Organization on the Regional Anti-Terrorist Structure*-August 16, 2007. As since its inception the SCO aroused the interest of other countries, on 24 April 2004 *the Regulations on Observer Status at the Shanghai Cooperation Organisation* were established. In subsequent years, observer status was given to: Afghanistan, Belarus, India, Iran, Mongolia and Pakistan, while dialogue partners status was given to: Armenia, Azerbaijan, Cambodia, Nepal, Sri Lanka and Turkey, and the two organizations such as the ASEAN and the Commonwealth of Independent States and Turkmenistan became Guest Attendances. Despite such a wide representation of countries of Eurasia, the membership of the SCO has not changed for 15 years. Currently, the Shanghai Cooperation Organization is on the eve of a spectacular extension. India and Pakistan in June 2016 signed a Memorandum on accession. During the 2016 Summit in Tashkent, Uzbekistan, the heads of the Shanghai Cooperation Organization member states put forward the formal admission of India and Pakistan as full members of the Organization. In 2017, India and Pakistan, through the signing of the memoranda of obligations, technically finalized the process of expansion of the SCO (Qadir and Rehman, 2016, pp.117-132; Korzun, 2016).

It is difficult to unambiguously answer the question of what shape the Shanghai Cooperation Organization is ultimately going to adopt. Without a doubt, this is a political and military structure, but the economic aspect is being emphasized in many documents and declarations related to the activities of the SCO as well. In accordance with the Charter of the Shanghai Cooperation Organization the goal of the SCO is, among other things, "to encourage the efficient regional cooperation in a dry spheres as politics, trade and economy, defense, law enforcement, environment protection, culture, science and technology, education, energy, transport, credit and finance, and also other spheres of common interest'(Charter of the Shanghai Cooperation Organization, Art 1., 2002). The potential of current and future members of the Organization provides great flexibility in the implementation of economic, political, cultural and virtually any other actions. However, the Shanghai Cooperation Organization is made up of many strong countries which are, at various levels, ambitious of playing a leading role in the region and the world. The international interests of the countries (mainly China and Russia) are not always convergent. Moreover, there are still outstanding territorial disputes and more among both the existing and new member states. All this makes it difficult to expect that the SCO will accept the direction of integration similar to the

European model, but in many respects the Shanghai Cooperation Organization can be extremely effective. One should agree with *Alyson J.K. Bailes* that the SCO is an organization of a new type, more multifunctional than traditional organizations, laying the emphasis on issues regarding differently understood safety (Bailes, 2007). The Shanghai Cooperation Organization can be also seen through the prism of regional integration understood as construction or differentiation of the region. Such a viewpoint is taken by the researchers affiliated with The United Nations University Institute on Comparative Regional Integration Studies (UNU-CRIS), *Philippe De Lombaerde* and *Luk Van Langenhove* (De Lombaerde and Langenhove, 2007, pp.1-4). Starting from the classic definition by *Joseph Nye* defining an integrating region as a certain number of countries linked to each other by geographical proximity and many interdependencies (Nye, 1971, p.vii) the researchers formulate their own definition. Regional integration and the construction of an integrated region is, according to them, "a multi-dimensional process of social transformation whereby actors associated with (sub-)national governance levels and belonging to a limited number of different states, intensify their interactions through the reduction of obstacles, the implementation of coordinated or common actions and policies, and/or the creation of regional institutions, thereby creating a new relevant (regional) space for many aspects for human behaviour and activities" (De Lombaerde, 2011, p.32; De Lombaerde, Estevadeordal and Suominen, 2008). Although in this context, the region that forms the Shanghai Cooperation Organization is extremely large, both in terms of geography, population, economy and cultural diversification.

It is worth noting that the SCO is part of the map of major international initiatives created by its members, such as the BRICS Bank, the Eurasian Economic Union, the New Silk Road and the Asian Infrastructure Investment Bank. These initiatives are not formally linked to each other but are changing the picture of contemporary geopolitical and geo-economic reality. The Russian Federation, in the framework of an active policy of regional international integration led first to the creation of the Customs Union of Belarus, Kazakhstan and Russia, then the Single Economic Space, and finally the Eurasian Economic Union (Czerewacz-Filipowicz, 2016). It does not neglect the Commonwealth of Independent States (the CIS) as well (Czerewacz-Filipowicz and Konopelko, 2017). So far 60 countries have been attracted to the Chinese initiative - the New Silk Road, which one by one are also becoming members of the Asian Infrastructure Investment Bank. So far neither in the case of the integration initiatives in the post-Soviet area nor in relation to the BRICS or a concept of the New Silk Road the European Union has developed any strategy of dialogue, although in the latter many European countries are involved in. All the more so because a formula of cooperation and dialogue with the SCO has not been prepared. The dominant forms of dialogue are bilateral relations with the EU and ASEM (ASEM, 2017)[1], in which take part some of the countries participating in the summits of the SCO.

2.THE SCOPE AND CHARACTER OF THE SCO

The main objectives of the SCO, in accordance with the Declaration and Charter (Charter of the Shanghai Cooperation Organization, Art 1, 2002; Declaration on the Establishment of the SCO, 2001), are: strengthening mutual trust, promoting effective neighborly cooperation in the political, economic, commercial, technical - scientific, cultural and educational plane as well as in the fields of energy, transport and environmental protection. In addition, an extremely important aspects here are safety and preservation of peace in the region,

[1] The Asia-Europe Meeting (ASEM) is an intergovernmental process established in 1996 to foster dialogue and cooperation between Asia and Europe. Presently it comprises 53 partners: 30 European and 21 Asian countries, the European Union and the ASEAN Secretariat. ASEM addresses political, economic, social, cultural, and educational issues of common interest, in a spirit of mutual respect and equal partnership.

protecting and promoting democratic principles and, what is clearly underlined on the organization's agenda, the creation of a new international economic and political order. Therefore, although cooperation within the organization began mainly with a security and military issue, the SCO has the potential to become an effective platform for economic and political cooperation. On the other hand, it is difficult to predict what shape it is going to take in the future. Individual countries participating in the Shanghai Cooperation Organization desire to realize different, particular goals through its agency. Since the SCO countries vary greatly in terms of economic and political potential as well as their international ambitions, their expectations related to the organization are different. *Jing-Dong Yuan* indicates that the organization is intended to "build a new international political order based on multipolarity in international relations and its opposition to interference in domestic affairs". According to him the SCO "is seen as the member states' consensus" as well. Referring to the Chinese expectations regarding the SCO, the author notes that although the issues of regional security are important for this country, however, „Beijing clearly sees the utility of the SCO in securing access to Central Asia's vast energy potentials, establishing its solid hold in regional economic cooperation and integration, and promoting the regional organization and its operating principles premised on the 'Shanghai Spirit'—mutual trust, mutual benefit, equality, consultation, respect for different civilization and common prosperity—as an alternative to post-Cold War security architecture" (Yuan, 2010, pp. 862-863).

For many years, the Russian Federation has conducted an effective policy of international regional integration realizing through it its goals, both regional and global. The Shanghai Cooperation Organization is part of a wide-ranging policy of integration of Russia next to the Eurasian Economic Union. The SCO and the EAEU not only strengthen the position of the Russian Federation in the international arena and put into practice the idea of multipolar world, both organizations contribute to the perception of Russia as a key element of the dialogue between Europe and Asia or Eurasia, or even the Euro-Atlantic structures and Asia.

Mikhail Troitskiy draws attention to the relationship between the SCO and the building of Russia's position in the international arena. According to him „Russian policymakers want the SCO to continue to act as an important symbol of rebuke to Russia's might-have-been strategic partners in the West and as a bargaining chip in negotiations with the USA." Moreover, according to *Mikhaila Troitskiy* "Russia seeks to establish itself as a 'bridge' between the SCO and Euro-Atlantic institutions, such as the EU or NATO, which have manifested their increasing interest in Central Asia. This move could serve to emphasize Russia's unique geopolitical position as a link between Europe and Asia, and raise its standing within the SCO itself" (Troitskiy, 2007, pp. 43-44).

Examining the SCO, *Timur Dadabaev,* indicates four approaches in the literature with reference to the objectives and role of the organization. Firstly, the SCO "is enhancing economic and political stability in this region", secondly, the organization "is depicted as a scheme designed to facilitate cooperation between the block of Russia-led CA countries and China." Thirdly, "in the Western discourse, the SCO is described as a political and military block led by anti-Western Russia and China against US and Western interests in the region." And fourthly, "some authors entertain the prospects of Sino - Russian competition in the CA as a separate pattern of present dynamics within the SCO area." (Dadabayev, 2014, pp. 102-103). Without a doubt the role that the SCO can play in the Eurasian region and the entire world's economy will evolve over time. The approach to the SCO as an alternative to color revolutions, popular in the years 2003-2005, is slowly losing its importance. The global roles the Shanghai Cooperation Organization can perform are clearly visible, especially in the policy of China and Russia.

According to the *Clive Archer's* (Archer, 2003, pp. 68-70) classification, the roles of international organizations can be divided into instrument, arena and actor. Each of these

roles is evident in the case of the SCO. International organizations are often used by the Member States as an instrument to pursue their own national interests, which is not a reprehensible practice, as the purpose of creating international organizations is to seek to maximize profits or secure peace by all possible means. Particular objectives of Russia and China, the countries wish to achieve with the SCO, are not open to doubt. However, the countries of Central Asia as well as new members such as Pakistan and India have very specific expectations of the SCO. The second frequently used role of the organization for security issues is the role of arena (forum) for consultation. International institutions are often perceived by the parties as an impartial arbiter, so that they can consult without fear that an issuer of aid is linked to the interests of the opponent. The role of the forum is very important from the point of view of smaller states (in this case, the Central Asian countries), for which the possibility of meeting with leaders of the countries of greater potential is the only opportunity to establish political contacts or engage in a debate on the economic stability of the region. However, the main task of international organizations as forums for exchanging ideas regarding safety is organizing the legal status of international cooperation, which is made by the SCO since its inception. Another role played by international organizations for security issues in the international arena is the role of independent actor acting to prevent disputes and conflicts, which means that they can make sovereign decisions and actions. This objective motivated the Shanghai Cooperation Organization from the very beginning. The range of the SCO interest, however, goes beyond security issues. Therefore, the roles performed by it in terms of the instrument and the actor are wider than those indicated above.
Examining the SCO *Pan Guang*, writing about the roles the SCO is to play, shows that, first, it has to accelerate and strengthen the "process of confidence building and increase the trust between China and nine of its close neighbors". “Second, the SCO provides a good framework for China to cooperate closely in combating terrorism, extremism, separatism and various other cross-border criminal forces.” The third role of the SCO from the perspective of China, indicated by *Pan Guang* is “the economic cooperation that the SCO is committed to pursuing is directly conducive to China’s programme for developing its western regions, particularly as it offers land-based routes for energy import and transport.” Finally, the fourth role of the SCO indicated by *Pan Guang* has a global dimension due to an enormous geographic, economic, political and population potential of the Member States. According to the author, the SCO has the opportunity to create „a zone of stability and development from Central Asia outward to South Asia, the Middle East and even more distant areas will create a favourable neighbourhood and international environment for China’s peaceful development” (Guang, 2007, pp. 45-47). Ambitions and expectations with regard to the SCO presented by the Member States from Central Asia relate mainly to ensure regional security, counter-terrorism and economic development. The economic dimension, however, is perceived differently by each Central Asian states, due to different determinants. The economic platform of cooperation between China and Central Asian countries are energy resources in which the CA region is rich, and which China needs. Energy cooperation entails a number of Chinese investments needed by all the countries of Central Asia for development. From the perspective of Kazakhstan, the largest and most rich in raw materials, to develop economic relations with China is one of the three main directions of economic cooperation alongside the European and Russian direction. In a small and poor Kyrgyzstan, the Chinese economic and population expansion, however, raises several concerns (Dadabayev, 2014, p.108). Among other things, that is why Kyrgyzstan joined the Eurasian Economic Union (EAEU) - the Russian economic integration initiative. Russia being also aware of China's economic power seeks to realize its economic cooperation with Kazakhstan and Kyrgyzstan mainly under the EAEU, not the SCO. The cooperation within the SCO is conducted within three main pillars: (I) regional security, which was the basis for the creation of the SCO; (II)

economic cooperation, which has become an essential element of cooperation between the member states, as an expression of aspirations for economic integration; (III) realization of political demands, namely, achieving common political goals of all member states.

A military and security plane is most evident in the activities of the SCO. According to *Jing-Dong Yuan* "Chinese analysts argue that the organization represents an embodiment of the new security concept and a new type of multilateral institution in the post-Cold War environment that is not a military alliance directed against any third parties, but is a process of dialogue and consultation on an equal basis, and a mechanism for enhancing regional cooperation in political and economic spheres. The 'Shanghai Spirit', which is the underpinning of the SCO, advocates mutual trust, mutual benefit, equality, and consultation, respects cultural diversity, and seeks common development. Essentially, it promotes confidence, communication, cooperation, coexistence, and common interests, and displays a new type of inter-state relationship, a new security concept, and a new model of regional cooperation" (Yuan, 2010, 861-862). The member states, observers and dialogue partners of the Shanghai Cooperation Organization want to solve the problems concerning regional security among themselves, excluding the US and NATO. This is evidenced by, for instance, the actions of the member states of the SCO in Central Asia (including the liquidation of the US bases in Uzbekistan and Kyrgyzstan) and Afghanistan.

At the economic level, an important direction of cooperation, both for the member states of the SCO, observer states and dialogue partners, is certainly fuel and energy cooperation, which aims to ensure energy security for buyers and suppliers. In 2006, Russia put forward the initiative to create the Energy Club of the SCO member states. The document was signed in 2007 and since then the Club has acted as the advisory body, which brings together representatives of business circles of government and experts to conduct a dialogue on issues of energy security (Jakimowicz, 2011). The economic relations between the countries of the SCO important are based on trade. Especially in the case of the countries of Central Asia, the share of SCO in their trade turnover is dominant (Own calculation on the base of IMF DOTS, 2016). In turn, Russia, since 2013, has indicated the area of Eurasia as an alternative to the relations with the European Union. It is difficult perhaps to attribute this fact to the Shanghai Cooperation Organization itself, but in recent years the share of the SCO in the trade turnover of Kyrgyzstan, Kazakhstan, Russia, Tajikistan and Uzbekistan, has been increasing (Own calculation on the base of International Monetary Fund. Direction of Trade by country, 2016) also for the new member states of the SCO, Pakistani and Indian partners. The SCO represents (mainly China) one of the most important directions of trade.

Decisions in the framework of the Shanghai Cooperation Organization are taken by consensus, except for decisions concerning the suspension or termination of membership. The organization also has its own budget, which is generated through contributions from the member states. A country in the region can join the SCO if it commits itself to abide by the purposes and principles of the Charter, the decisions of other international agreements and documents adopted within the framework of SCO. The decision to accept a new member of the SCO is taken by the Council of Heads of State, at the request of the Council of Ministers of Foreign Affairs (Wańczyk, 2016). A complement to the Charter is *the Treaty Of Good Neighborliness, Friendship And Cooperation* signed on 16 August 2007, which emphasizes the right of states to choose the political system, the inviolability of borders and it confirmed the agreement on non-participation in alliances directed against other Member States of the SCO (Olędzki, 2016). *Evgeny Vinokurov* and *Alexander Libman* (Vinokurov and Libman, 2012, p.60) examining the SCO in the context of interregional projects in Eurasia emphasize that the organization has proved its competence in the field of regional security.

They emphasize, however, that the scope, nature and future of the organization are dependent on how the relationship between China and Russia, according to the researchers the key countries of the SCO, will shape.

3. THE EUROPEAN RELATIONS WITH THE SCO

The potential of the SCO is huge. The organization includes the largest (Russia, China, Kazakhstan, India) and the most populous countries of the world (China, India, Pakistan). In terms of GDP, there are the second (China) and seventh (India) economies in the world among the countries of the SCO (IMF, 2016). Until recently, there was also Russia in the top ten countries with the highest GDP and there are good reasons to believe that it will come back there one day**.** The states of the SCO are also extremely rich in raw materials. Russia has the world's second-largest natural gas reserves, while resources of China, Kazakhstan and Uzbekistan are among the largest 20 in the world. If you were to take into account not only the member states of the SCO but also the observers and dialogue partners, it would turn out that these countries have 40% of world reserves of this raw material (BP, 2016, pp. 20-22). The Russian Federation also has one of the largest oil reserves, in the first fifteen of the countries with the greatest resources are also Iran (a dialogue partner of the SCO) and Kazakhstan (BP, 2016, pp. 6-8). Russia and China have spectacular coal resources, while Russia and Kazakhstan are world leaders in the production of uranium. There are resources of all known materials in the area of the SCO. Besides, China is now the biggest export power in the world, India and Russia are in the top twenty countries with the greatest export in the world (Central Intelligence Agency. The World Factbook, 2016).

First of all, the Shanghai Cooperation Organization brings together countries with enormous military potential. Currently, the second, third and fourth military powers in the world (Russia, China and India) are among the SCO. In the first 15 military largest powers are: Pakistan - a new member of the SCO and Turkey - a dialogue partner of the SCO (Global Firepower (GFP). Countries Ranked by Military Strength, 2016)**.** In 2017, there are going to be four countries with nuclear weapons: Russia, China, India and Pakistan among the countries of the SCO, while globally the access to this type of weapon is possessed by only 9 countries (Global Firepower (GFP). Countries Ranked by Military Strength, 2016).

From the perspective of each region of the world, actions taken within the framework of the SCO seem to be relevant. For the European Union, in addition to any of the above data characterizing the potential of the SCO states, important is the fact that now the trade turnover with the countries of the SCO accounts for about one-quarter of the total extra-EU trade. It is mainly the effect of constantly growing position of China in the EU exports and imports. In 2015, China was the second largest trade partner of the EU but the growth dynamics of mutual trade is so large that probably in the next few years it will overtake the US, becoming the most important trading partner of the EU. Even now, the EU countries import from China the most and it is more than 20% of all imports. Taking into account the potential and trade links between China and the EU (European Commission. Trade, China, 2016), mutual foreign investments are not at such an impressive level as would be expected, however, the only agreement binding the EU and China in the future is to concern *A Comprehensive EU-China Investment Agreement*. Numerous forums dealing with bilateral cooperation: BusinessEurope, the European Union Chamber of Commerce in China and the EU-China Business Association and mainly the EU-China Summits do not lead to a comprehensive, economic and even more political agreement. On the other hand, the Chinese concept of the New Silk Road (One Road, One Belt) seems to be an effective instrument to build economic and infrastructural links with individual European countries without creating a ground for cooperation with all the European Union as such. Globally, the EU, in accordance with its declarations (European Commission. Trade. 2016) and the actual state, is

one of the structures most open to the outside. According to the World Trade Organization, the EU has signed more than 50 RIAs (Regional Integration Agreements) (WTO, 2016) relating to trade in goods and/or services. None of them, however, does not concern the Shanghai Cooperation Organization area. With part of the member States of the SCO, that is, Kyrgyzstan, Tajikistan, Uzbekistan, India and Pakistan, the EU, as a provider, signed the PTE (Preferential Trade Agreement) (World Trade Organization. Participation in Preferential Trade Agreements. European Union, 2016). It lacks, however, a coherent form of cooperation with the region and its most important countries, called for by the EU in the relations with different geographical areas. At present, the SCO is not a RIA in the trade aspect or any economic dimension, but it favors the economic relations between the member states. Moreover**,** both in official documents of the SCO and the official Summits, various aspects of economic cooperation among the member states appear. For this reason, not only for political reasons, the EU dialogue with the SCO would benefit all the participating States. The SCO has already developed a platform for dialogue with the CIS and ASEAN.

The European Union has not developed any effective formula for political and economic cooperation with the Russian Federation. Functioning since 1997, *The Partnership and Cooperation Agreement between the EU and Russia* is in fact insufficient and inadequate to the needs. In the case of Russia, since 2013, that is, the Russian-Ukrainian conflict and the Russian annexation of the Crimea, the relations with the European Union have become strained. As a result, the EU-Russia embargo in the mutual relations has not been lifted and economic interdependence has declined. Nevertheless, Russia is still the third supplier of goods (mainly raw materials) on the EU market, the fourth largest trading partner of the EU and some countries of Central and Eastern Europe are totally dependent on the Russian supplies of raw materials. Central and Eastern Europe is totally dependent on Russian supplies of raw materials. Starting from the collapse of the USSR, the European Union (formerly the European Community) has not worked out and not proposed the Russian Federation or any integration structure associated with it, eg. the CIS and the Eurasian Economic Community, a complex form of cooperation. The Eastern Partnership (EaP)[2] or DCFTAs (Deep and Comprehensive Free Trade Agreements)[3] have been prepared by the European Union only for selected countries of the post-Soviet area and do not apply to either Russia or Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. The European Union and Central Asia: Strategy for a New Partnership is not an effective instrument as it is in the case of EaP and DCFTA. This is despite the fact that the region of Central Asia (Putz, 2015) is an area of interest to the EU because of its natural resources and geostrategic position. On 21 December 2015, *The Enhanced Partnership and Cooperation Agreement* (EPCA) was signed between Kazakhstan and the European Union. The EPCA regulates trade and economic relations between the two entities (European Union. External Actions, 2016). Kazakhstan and the EU, 2016). Both structures are important economic and political partners for each other but the scope of mutual cooperation, by definition, is somehow limited. The Eurasian Economic Union started its functioning on 1 January 2015. Its members became Russia, Kazakhstan, Kyrgyzstan, Belarus and Armenia. The EAEU is meant to take at least a form of the common market as Belarus, Kazakhstan and Russia have already been within the framework of the Customs Union and the Single Economic Space. The new structure of the EAEU has any legal basis for developing international cooperation. The Eurasian Economic Commission, functioning as an organ of the EAEU, in external relations, can negotiate and

[2] The Eastern Partnership (EaP) is a joint policy initiative launched at the Prague Summit in May 2009. It aims to deepen and strengthen relations between the European Union and its six Eastern neighbours: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.

[3] The Deep and Comprehensive Free Trade Areas (DCFTA) are three free trade areas established between the European Union, and Georgia, Moldova and Ukraine respectively.

build a platform for cooperation with other countries and groupings, eg. With the EU (Treaty on the Eurasian Economic Commission, 2011). For this reason, it seems that at this stage of institutionalization of international relations in Eurasia, the EU should be interested in developing forms of cooperation with all organizations such as the EAEU and the SCO.
Greg Austin argues that "the EU needs to shape its foreign policy toward the SCO in three directions. First, the EU needs to craft policies that see the geographic base of effective regionalism in Heartland Asia as including Russia and China.(…) Second, the EU needs to spend policy capital pressing China and Russia to resist strictly bilateral approaches in favor of policies that enhance the SCO, and to encourage Russia and China to contribute more actively and effectively to the SCO through technical assistance if not money. Third, the EU must convince the USA to resist strictly bilateral approaches helping Central Asian states in favour of policies that promote the effectiveness of the SCO" (Austin, 2002, pp. 7-8). Similarly, *Marcel de Haas* argues the need for cooperation between the European Union and NATO and the Shanghai Cooperation Organization (Haas, 2014). It is, however, worth pondering over whether or not, for its future reasons, the present European Union should consider a more specific policy directed towards the SCO. A similar problem appears regarding the EU-EAEU relation, the EU-BRICS relations and the concept of the New Silk Road. The EU sees both the SCO and other initiatives rather as a set of individual countries, and not as separate entities of modern global economy. For the EU, particularly in the context of the SCO and the EAEU, the creation of a platform with these organizations, could paradoxically turn out to be easier than a difficult relationship, eg. with Russia. On the other hand, it is possible that the reasons for this state of affairs are unsolved problems inside the EU itself, which is not able to conduct a uniform policy in the face of the Chinese and Russian initiatives. Individual European countries prefer to be driven by particularistic interests instead of building a common EU policy towards the SCO, the EAEU or the New Silk Road.

4. CONCLUSION

Undoubtedly, the Shanghai Cooperation Organization can be a powerful organization due to the potential of its member states. However, it is difficult to determine today what shape the organization is going to take. The SCO is effective in a fight on extremism and terrorism as well as it has a positive effect on political relations between the member states. A chief asset of the organization is also active participation in the peaceful solving of border disputes between the SCO countries**.** It seems, however, that the ambitions of individual states belonging to the SCO are far more extensive. Energy, economic and geo-political potential of the members of the organization can be used to create more effective economic cooperation.
According to *Jing-Dong Yuan*, "the SCO could be a forum to try out its leadership role in a region of increasing importance to China's future socio-economic development—including energy security and internal social stability. However, for that to happen, Beijing needs to promote the SCO's functional spill-over from security and anti-terrorism to economic cooperation; its institutionalization and expansion; and the collective identity that member states endorse and nurture. At the same time, Beijing must be sensitive to Moscow's pride and traditional role in the region without being too deferential" (Yuan, 2010, p. 862). On the other hand, both Russia and China are simultaneously running a number of initiatives that strengthen their economic integration with selected countries in Europe and Asia. It is worth mentioning here, in the case of Russia - the EAEU, while in the case of China - the concept of the New Silk Road integrating economically "in a new way" many countries of Eurasia. The question arises, therefore, whether or not it will come to strengthening economic cooperation within the framework of the SCO as well. Starting from 2017, Pakistan and India are going to become new members of the organization, and the opinions of the new members

may influence the directions of future cooperation within the Shanghai Cooperation Organization. From the perspective of the European Union, the SCO is extremely important, and the reason for this state of affairs can be divided into at least two groups. Firstly, there are important economic and political EU partners in the SCO (China and Russia, and soon also Pakistan and India). Besides, the SCO possesses energy resources the EU needs and it has a decisive influence in Central Asia as well as an impact on the economic development of the neighbors of the EU. Secondly, however you look at it, the SCO is a new element of international security and both the EU and other countries of the world must take this into account. The EU-NATO political cooperation with the SCO could contribute to a number of benefits in the territory of Eurasia. Perhaps if such a forum of cooperation was established, it would be easier to find a solution to the conflict in Ukraine, and perhaps in Syria. Both bloody wars are taking place actually at the junction of the SCO (and other structures associated with it) and the Euro-Atlantic structures (the EU and NATO).

ACKNOWLEDGEMENT: *Research carried out under work No. S / WZ / 1 / 2014 and financed from the resources for science of Ministry of Science and Higher Education*

LITERATURE:

1. (21.11.2016) China Eyes Turkey For Shanghai Cooperation Organization. The American Interests. [electronic document] http://www.the-american-interest.com/2016/11/21/china-eyes-turkey-for-shanghai-cooperation-organization/. Accessed on 5 December 2016.
2. Agreement Between the member states of the Shanghai Cooperation Organization on the Regional Anti-Terrorist Structure signed on 7 June 2002
3. Agreement on Confidence Building in the Military Field in the Border Area signed on 26 April 1996.
4. Agreement on the Database of the Regional Anti-Terrorist Structure of the Shanghai Cooperation Organization signed on 28 June 2004
5. Archer, C. (2003). International Organizations. Third edition. London and New York: Routledge. Taylor and Francis Group.
6. Asia-Europe Meeting (ASEM). http://www.aseminfoboard.org/about. Accessed on 5 January 2017.
7. Austin, G. (2002). European Union Policy Responses to the Shanghai Cooperation Organization. European Institute for Asian Studies (EIAS).
8. Bailes, A.J.K., Dunay, P., Guang P. and Troitskiy M. Shanghai Cooperation Organization, SIPRI Policy Paper No. 17.
9. BP Statistical Review of World Energy. June 2016.
10. Central Intelligence Agency. The World Factbook. https://www.cia.gov/library/publications/the-world-factbook/rankorder/2078rank.html. Accessed on 15 December 2016.
11. Charter of the Shanghai Cooperation Organization signed on 7 June 2002.
12. Concept of Cooperation Between the SCO Member States in Combating Terrorism, Separatism, and Extremism signed on 5 June 2005.
13. Czerewacz-Filipowicz, K. (2016). Regionalizm i regionalizacja w Euroazjatyckiej Unii Gospodarczej. Wpływ EAUG na integrację handlową państw członkowskich z gospodarką światową (Regionalism and regionalization in the Eurasian Economic Union. The EAEU impact on trade integration of the Member States with the world economy). Bialystok: Bialystok University of Technology Publishing House.
14. Czerewacz-Filipowicz, K. and Konopelko, A. (2017). Regional Integration Processes in the Commonwealth of Independent States – Economic and Political Factors, Cham: Springer International Publishing AG.

15. Dadabaev, T. (2014). The Shanghai Cooperation Organization (SCO) Regional Identity Formation from the Perspective of the Central Asia States. Journal of Contemporary China. Vol. 23, No. 85. Pp. 102–118.
16. De Haas, M. (7.05.2014) The EU and NATO engagement with the Shanghai Cooperation Organization: Afghanistan as a pilot. Europe's world [electronic document] http://europesworld.org/2014/05/07/eu-and-nato-engagement-with-the-shanghai-cooperation-organization-afghanistan-as-a-pilot/#.WKNIcH9WSek. Accessed on 5 January 2017.
17. De Lombaerde, P. (2011), Comparing Regionalism: Methodological Aspects and Considerations [in:] eds.: Shaw, T., Grant, A. and Cornelissen, S. The Ashgate Research Companion to Regionalisms. Farnham: Ashgate.
18. De Lombaerde, P. and Van Langenhove, L. (2007). Introduction [in:] ed.: De Lombaerde P. Multilateralism, Regionalism and Bilateralism in Trade and Investment. Dordrecht and New York: Springer, pp. 1-4.
19. De Lombaerde, P., Estevadeordal, A. and Suominen K. (eds.) (2008). Governing Regional Development: Monitoring Experiences, Methods and Prospects. Aldershot: Ashgate.
20. Declaration on the Establishment of the Shanghai Cooperation Organization signed on 15 June 2001
21. Declaration on the Establishment of the Shanghai Cooperation Organization signed on 15 June 2001
22. European Commission. Trade. China. http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113366.pdf Accessed on 15 November 2016.
23. European Commission. Trade. [electronic document] http://bookshop.europa.eu/en/trade-pbNA0216154/;pgid=GSPefJMEtXBSR0dT6jbGakZD00002lqJq80Q;sid=wK1O4AACmVJO_liqZSDQR2Inx35IM01h3t8=?CatalogCategoryID=luYKABst3IwAAAEjxJEY4e5L. P. 3. Accessed on 5 December 2016.
24. European Commission. Trade. China. http://ec.europa.eu/trade/policy/countries-and-regions/countries/china/. Accessed on 5 December 2016.
25. European Union. External Actions. (12.05.2016). Kazakhstan and the EU. https://eeas.europa.eu/headquarters/headquarters-homepage/1367/kazakhstan-and-eu_en. Accessed on 5 January 2017.
26. Global Firepower (GFP). Countries Ranked by Military Strength (2016) http://www.globalfirepower.com/countries-listing.asp. Accessed on 15 December 2016.
27. International Monetary Fund. Direction of Trade by country. http://data.imf.org/?sk=253a4049-e94d-4228-b99d-561553731322&sId=1390030109571. Accessed on 15 December 2016.
28. International Monetary Fund. World Economic Outlook Database, October 2016. https://www.imf.org/external/pubs/ft/weo/2016/02/weodata/ Accessed on 15 December 2016.
29. Jakimowicz, R. (2011). Szanghajska Organizacja Współpracy – wymiar gospodarczy (Shanghai Cooperation Organization – economic dimension). [in:] eds.: Pietrasiak, M. and Stańczyk, M. Problemy społeczno-gospodarcze Syberii (Socio-economic problems of Siberia). Łódź: Ibidem Publishing House.
30. Korzun, P. (29.06.2016). Shanghai Cooperation Organization: Story of Success and Expansion. Online Journal. Strategic Coulture Foundation. [electronic document] http://www.strategic-culture.org/news/2016/06/29/shanghai-cooperation-organization-story-success-expansion.html Accessed on 5 September 2016.

31. Nye, J.S. (1971). Peace in Parts: Integration and Conflicts in Regional Organization, Boston: Little, Brown and Company.
32. Nye, J.S. (2004). Soft Power. The Means to Success in World Politics. New York: PublicAffairs.
33. Olędzki J. Unia Europejska – Szanghajska Organizacja Współpracy: perspektywy kooperacji wobec zagrożeń globalnych (The European Union - The Shanghai Cooperation Organization: prospects for cooperation against global threats). [electronic document] http://www.ce.uw.edu.pl/pliki/pw/jerzy_oledzki.pdf, Accessed on 5 November 2016.
34. Protocol on Amendments to the Agreement Between member states of the Shanghai Cooperation Organization on the Regional Anti-Terrorist Structure signed on 16 August 2007.
35. Putz, C. (22.12.2015). Central Asia 'Extremely Important' to the European Union. The Diplomat. [electronic document] http://thediplomat.com/2015/12/central-asia-extremely-important-to-the-european-union/. Accessed on 15 September 2016.
36. Qadir, M.I. and Rehman, S. (2016). Expansion of Shanghai Cooperation Organization (SCO) Harbinger of Regional Peace and Prosperity. Journal of Political Studies, Vol. 23, Issue - 1, 2016, 117:132.
37. Regulations on Observer Status at the Shanghai Cooperation Organisation signed on 24 April 2004.
38. Republic of Turkey Ministry of Foreign Affairs. Shanghai Cooperation Organization. http://www.mfa.gov.tr/shanghai-cooperation-organization.en.mfaWang. Accessed on 15 September 2016.
39. Republic of Turkey Ministry of Foreign Affairs. Turkey and The Shanghai Cooperation Organization Dialogue Partnership Memorandum was signed in Almaty. http://www.mfa.gov.tr/turkey-and-the-shanghai-cooperation-organization-dialogue-partnership-memorandum-was-signed-in-almaty.en.mfa. Accessed on 15 September 2016.
40. Shanghai Convention on Combating Terrorism, Separatism and Extremism signed on 15 June 2001.
41. Sikora-Gaca, M. (2015) Szanghajska Organizacja Współpracy i jej wpływ na kształtowanie globalnego zarządzania (Shanghai Cooperation Organization and its Influence on the Global Governance) [in:] Instytucje międzynarodowe w dobie globalnego zarządzania (International Institutions in the Global Governance Era) ed.: Rewizorski, M. Warsaw: Elipsa.
42. Treaty Of Good Neighborliness, Friendship And Cooperation signed on 16 August 2007.
43. Treaty on the Eurasian Economic Commission [Договор о Евразийской экономической комиссии] (2011). http://www.eurasiancommission.org/ru/Lists/EECDocs/Договор о ЕЭК.pdf. Accessed on 5 August 2016.
44. Vinokurov, E. and Libman, A. (2012). Eurasian Integration: Challenges of Transcontinental Regionalism, London: Palgrave Macmillan.
45. Wańczyk, K. Szanghajska Organizacja Współpracy (The Shanghai Cooperation Organization) [electronic document] http://www.psz.pl/168-archiwum/szanghajska-organizacja-wspolpracy Accessed on 30 November 2016.
46. Wang, L. (24.11.2016). Will Turkey Join the Shanghai Cooperation Organization Instead of the EU? The Diplomat. [electronic document] http://thediplomat.com/2016/11/will-turkey-join-the-shanghai-cooperation-organization-instead-of-the-eu/. Accessed on 5 December 2016.
47. World Trade Organization. Participation in Preferential Trade Agreements. European Union. http://ptadb.wto.org/SearchByCountry.aspx. Accessed on 15 November 2016.

48. World Trade Organization. Participation in Regional Trade Agreements. European Union. http://rtais.wto.org/UI/PublicSearchByMemberResult.aspx?MemberCode=918&lang=1&redirect=1. Accessed on 15 November 2016.
49. Yuan, J. (2010). China's Role in Establishing and Building the Shanghai Cooperation Organization (SCO) Journal of Contemporary China. 19(67). November. Pp. 855-869.

THE INFLUENCE OF WORKER'S CHARACTER ON THE EFFICIENT SELLING PROCESS AND INTERNATIONAL COMPETITIVENESS OF CROATIAN HOSPITALITY MANAGEMENT

Tomislav Galovic
Faculty of Economics University of Rijeka, Croatia
tomislav.galovic@efri.hr

Heri Bezic
Faculty of Economics University of Rijeka, Croatia
heri.bezic@efri.hr

Sasa Popov
Faculty of Economics University of Rijeka, Croatia
popov90sasa@gmail.com

ABSTRACT

Croatian tourism and hospitality management shows great potential in achieving higher level of international competitiveness. However, Croatian tourism and hospitality management is under the influence of internal and external factors. In year 2017, one of the relevant internal factors is fiscal policy, which has major impact on whole business activity of tourism and hospitality management sector. In order to be more competitive on the market, hospitality management capacities should rely on their human resources in order to provide added value for guests and enhance their market position. The research was conducted in year 2017 as secondary research covering all Croatian counties with 240 examined representatives of Croatian hospitality management. Research is focused on the effective selling techniques and solving conflicts and their impact on selling process and offer of Croatian hospitality management.

Keywords: *Croatian hospitality management, International competitiveness, Selling process*

1. INTRODUCTION

The tourist sector has a considerable impact on the Croatian economy. The UNWTO definition on tourism says that tourism includes activities that originate from journey and stay of persons out of their usual surroundings not longer than one year with the purpose of rest, business travel and other reasons free of activities that would imply any compensation in the destination they visit (Cicvarić, 1990, p. 63), while the hotel industry is the activity organizing, offering and satisfying the guests' needs in the suervices such as accomodation, food, retailing drinks, and beverages. Apart from the above the hotel industry also satisfies other guests' needs such as social, health, cultural and other people's necessities motivating them to visit or look for a speific service in a tourist facility (Cerović, 2003, p. 63).

The hotel industry offers services with the purpose of selling most services in the best possible way with the assumption that the characters of the employees considerably influence on the efficient sale and in solving possible conflict situations. Some authors state that there is no connection between a successful sale and the negotiator's character, while others, on the other hand, state that his character very much influences a successful sale.

The objective of this research is to confirm if the characters influence a successful sale in tourism, and in case the answer appears to be affirmative, to find out what they really are. Besides the objective is to show how these characters influence not only a successful sale but also help in solving various conflict situations the hotels are faced with every day.

The work hypothesis based on the primary research, realized in a survey, will be to draw a conclusion that the characters of touristic employees in Croatia essentially influence the solving of conflict situations as well as the successful sale of the products. The objects of the research are the tourist sector, characters, conflicts, sale. The thesis consists of five sections connected interactivelly. Following the ***Introduction***, the second sectionanalytical aspects and basical characteristics of the tourist sector are presented and its influence on the Croatian Economy. It also considers the influence of the tourist sector on the employment and the way it grows. The third section is about the research methodology. The fourth section deals with the primary research results. The fifth one is obout the conclusions and recommendations that might be useful in business increase and its efficiency.

2. ANALYTICAL ASPECTS OF THE TOURIST SECTOR IN CROATIA

Croatia a tourist country possessing very good conditions in offering tourist services owing to the fact that it is situated on the Adriatic see with 1244 islands with the most indented coastline in the Mediterranean area. (http://www.htz.hr, 2017). A tourist is a person that travells into a place that is not his residence and stays there more than 24 hours and his motive of travelling is not a matter of payed activity (Križman-Pavlović, 2008, p. 6). The majority of tourists come to Croatia during the summer months when the season starts from May to September although the July and August are months with the highest income. This is the period in which the croatian income rises mostly so ithere is no wonder why so much care is dediceted to it. The Chart 1 shows the number of tourist **overnights** per month starting from May to December 2016. So one can easily notice how the season in the named period influences the tourists to stay and the to what extent the realization of accomodation of foreign tourists is effected and the same concerning the domestic toruists respectively compared with the rest of the months of the year.

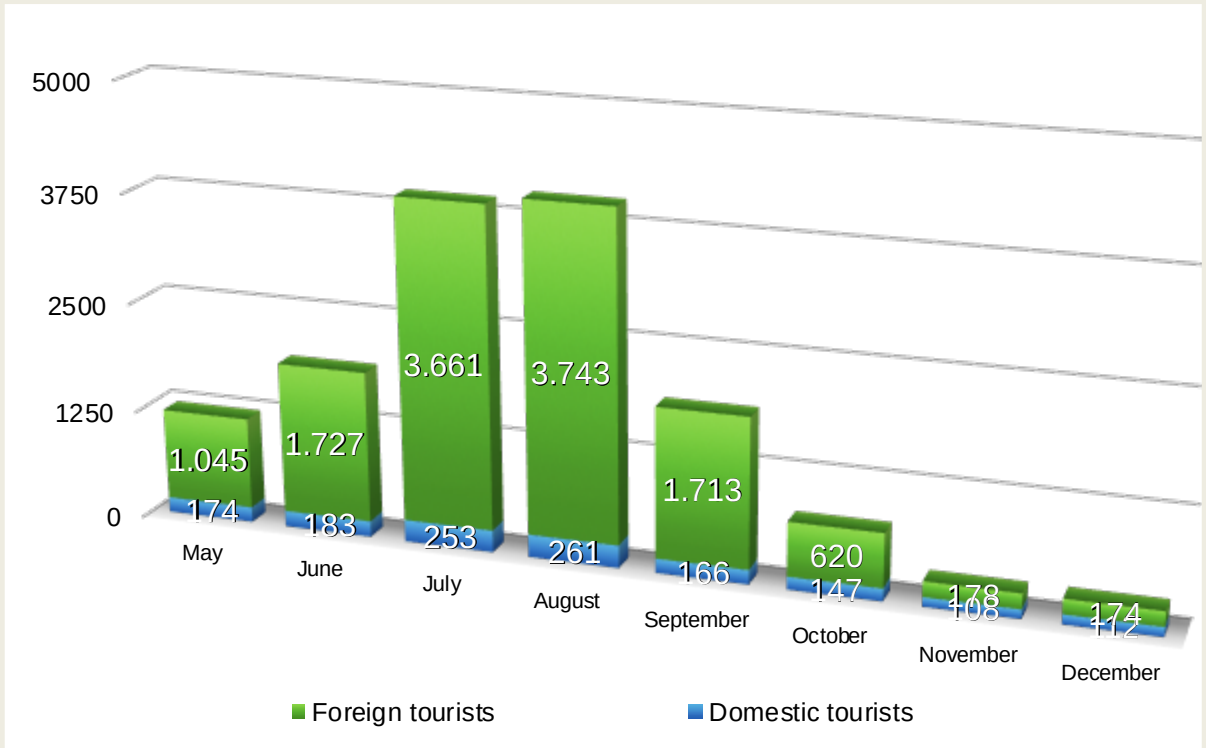


Chart 1: Arrivals and overnights *of tourists in 2016 – in thousands (The author according to the Croatian Chamber of of Economy, Economic fluctuation 2017.)*

One can conclude from the chart that the foreign tourists participate with more accomodation than the domestic ones in the course of the whole year. In May 2016 more than 174.000 overnights were effected by domestic tourists compared to 1.045.000 overnights by the foreign tourists. In June 2016 foreign tourists were accomodated 183.000 times while the domestic ones effectuated 1.727.000 overnights. In July there were 3.661 overnights by the foreign tourists compered to the domestic tourists' 253 .000 overnights. In August the highest rate of domestic and foreign tourists' overnights was effected with 261.000 of domestic and 3.743.000 overnight of foreign tourists. In September there is a slight fall of overnights registered so that the foreign tourists make 1.713.000 while the domestic ones 166.000 overnights. In October the trend of decrease continues so that the foreign tourists make 620.000 and the domestic ones 147.000 overnights. The decrease continues in November effected by the foreign tourists' of 178.000 overnights while the domestic ones effect the lowest rate of 108.000 of the year with 108.000 overnights. In December the foreign tourists effected the lowest number of 174.000 overnights.

Followed by the domestic ones with 112.000 overnights. The chart offers a conclusion that May is the month when the growth starts, that July and August are the months with the highest number of overnights are effected by both the domestic and foreign tourists. In September the number of acconmodations starts to fall in both groups of domestic and foreign tourists, November and December with the lowest number of tourists evidenced.

On this basis we can conclude that the number of tourists in the early season the number of tourists in May and June is less than in full season, in the „heart“ of July and August. In addition, there is a less number of tourists realizing overnights in September in the beginning of the post season, following July and August. It is presented in which months the maximum of overnights is realized, i.e. the period when a majority of tourists stay in Croatia and it will be analysed how much the tourism income in fact influences the total income in the national budget. The following table shows what is the influence of the foreign currency on total national budget incomes per years in the years from 2012 to 2016 in order to point out the importance of the tourist sector as activity that contributes greatly to the economy income.

Table1: Influence of the foreign currency tourist income on total national income in millions of Euros in the period between 2012 and 2016 (The author - according to the Croatian Chamber of Economy data, Economic fluctuations 2017)

Years	2012	2013	2014	2015	2016
Foreign currency income from tourism	6.858,0	7.202,4	7.401,7	7.961,2	8.300,0
National budget total income	14.574,1	14.337,4	14.946,9	14.339,7	15.363,3

The table shows that the foreign currency income from the tourism in 2012 amounted to 6.858 millions Euro, the total National budget income was 14.574 millions Euro. The 2013 total National budget income ammounted to 14.337 millions Euro, the total foreign currency income from tourism was 7.202 millions Euro. The total National budget income in 2014 was 14.946 millions Euro while the foreign currency from tourism was 7.401 millions Euro. In

2015 the total National budget income amounted to 14.339 millions Euro, the tourism total foreign currency was 7.961 millions Euro.
The year 2016 is the year with the highest tourist income increase with 8.300 million Euro the National budget was also the highest in the last five years and amounted to 15.363 millions Euro. The data in this table show that the tourism has been contributing great incomes to the National budget and that in the last five years it has been continouously increasing and represents a very special importance for the Croatian budget. The continuing growth of income from tourism in Croatia is also due to the Greek crisis and demonstrations in the arabic world, the so called „Arabian spring" starting in Tunis in 2010 spreading to the Northern Africa and Middle East (http://hrcak.srce.hr/142024 2012). In the following chart you will find what was the rate of foreign currency from tourism in the National budget income for the period 2012 to 2016.

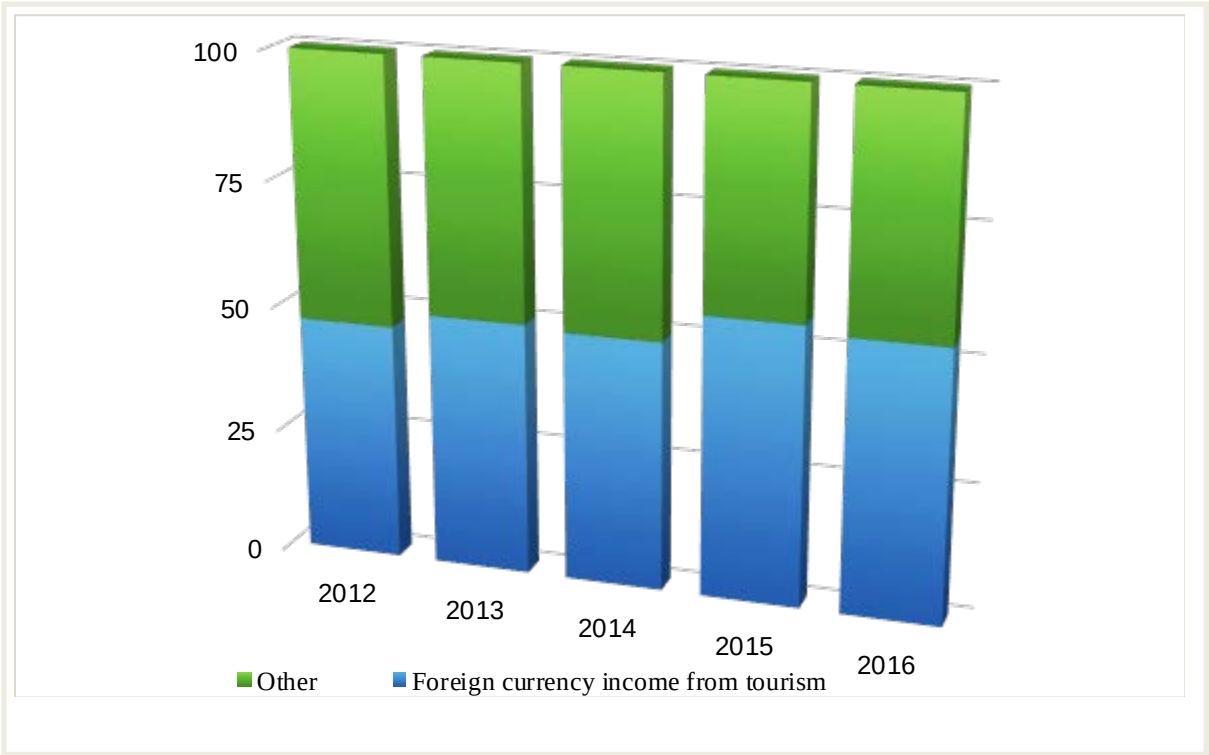


Chart 2: The share of the foreign currency income of tourism in the total National budget income in the period 2012 to 2016 (The author according to the Croatian Chamber of Economy data, Gospodarka kretanja 2013 - 2017., HGK)

The chart shows that in 2012 the foreign currency income from tourism amounted to 47,1% of the National budget while the other incomes share the 52,9%. In 2013 the foreign currency tourism share was 50,2%, the rest of them shared the 49,8%. In the year 2014 the foreign currency income from tourism was 50,5% share in the budget. Then in 2015 the tourism foreign currency income had had its greatest share in the National budget, in the last five years, namely even 55.5%, the other incomes were 44.5%. In 2016 the tourism foreign currency income was 54,0% in relation to the other incomes of 56% in the National budget. The chart shows that the foreign currency income from tourism has a great share in the National budget and that in the last five years it varied between 2013 and 2016 with 47.1 % to 55.5% that was very significant for the National budget and the Croatian economy. Besides the great incomes, the tourist sector, together with the start of the season influences in a

positive way the employment in Croatia. During the tourist season it has the tendency of growth.

Further on the chart will present the period between 2013 to 2016 in regard to the tourism influence on the increasing or decreasing of employment as early as in May when the early season starts to September when post season beginns as well as the month of January when there is no tourist season on.

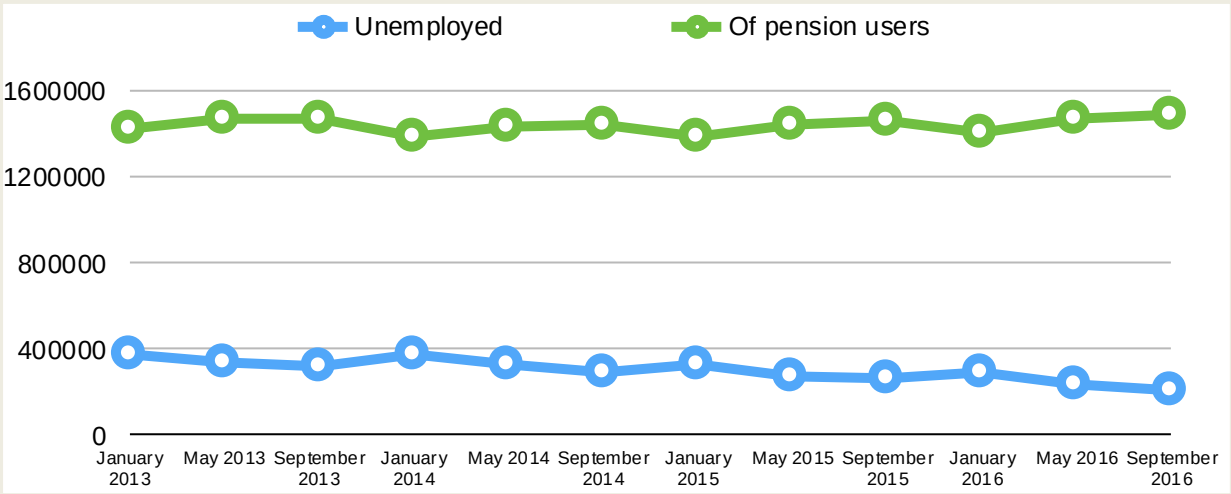


Chart 3: The influence of the start of tourist season on the increase of users of the pension fund and unemployment in the period between the years 2013 and 2016 (The author according to the data from the Croatian Employment Service - HZZ http://www.hzz.hr/default.aspx?id=10052 and the Croatian Pension Insurance Institute - HZMO http://www.mirovinsko.hr.aspx?id=10433)

The Chart 3 shows that the start of the tourist season influences positively on employment so that in every May of the years in focuse there is a majority of beneficiaries of pensions, the smaller portion of the employed appear in January when there is no tourist season. In September the employment is higher than in January, with a slight flow, though. On the other hand the unemployment curve in all the monitored years is the lowest in May meaning that the unemployment is then the lowest too. The highest unemployment was recorded in January 2014 while the lowest unemployment was in May 2016. At the same time the greatest number of beneficiaries of the Pension Security was in May 2016 the lowest in January 2014. We can conclude that the tourist season influences in a positive way the growth of employment and lowering the number of uneployment in relation to the months out of tourist season.

3. METHODOLOGY

The intention of this research is to confirm the importance of the influence that the caterer's character has in solving conflict situations as well as on a successful sale of services. The results of the research show if the caterer's character really influences a really successful sale of services and solving conflict situations, as well as the work productivity that in the end leads to the competitiveness of a company itself. The point in question is of the primary research implemented in various counties in the Republic of Croatia, namely the Istrian County, Krapina Zagorje County, Međimurje County, Osijek Baranja County, Primorje

Gorski Kotar County. Split Dalmatia County, Vukovar Srijem County, Zadar County, Zagreb County and others (the rest of them). Table 2 shows the number of the respondents from various Counties in Croatia as follows.

Table 2: The number of the respondents from various Counties in Croatia (The author according to the research results

COUNTY	NUMBER OF RESPONDENTS
Istrian	11
Krapina Zagorje	1
Međimurje	2
Osijek Baranja	3
Primorje Gorski kotar	66
Sisak Moslavina	2
Split Dalmatia	11
Vukovar Srijem	1
Zadar	6
Zagreb	68
The rest of them together	69
Total	240

The table 2 shows that there have been altogether 240 respondents involved in the research. The greatest number of 69 respondents come from other Counties, after the a great number of them come from the Zagreb County, 68 of them ,followed by Primorje-Gorski kotar County with 66 of them, Istrian County and Split –Dalmatia Counties with 11 respondents each, Zadar County with 6 respondents. Following the Zadar County there are Osijek Baranja County with 3, Međimurje and Sisak Moslavina County with 2 each and in the end Krapina Zagorje and Vukovar Srijem with one respondent each.

The sex structure of the respondents is as follows.

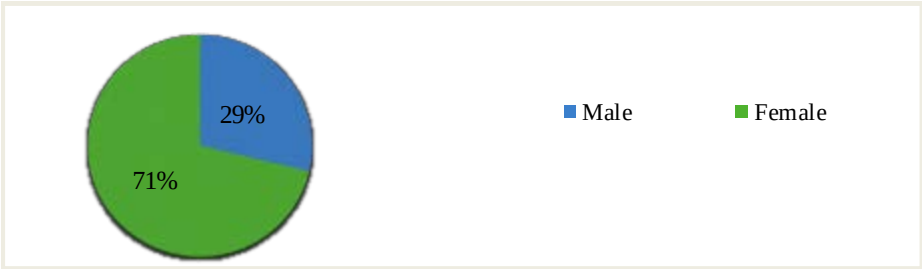


Chart 4. Respondents by sex (The author according to the research results)

We can conclude by the Chart 4 that there are 71% female and 29% male respondents, or in numbers 171 female and 69 male respondents in the catering industry. The sex of the respondents is a very important matter owing to the hypothesis that women and men have different opinion on how a successful sale is achieved and which is the best way to solve a conflict situation so they expose different ideas than their male colleagues. Besides by sex the respondents can be presented by age, too. Here comes the next structure:

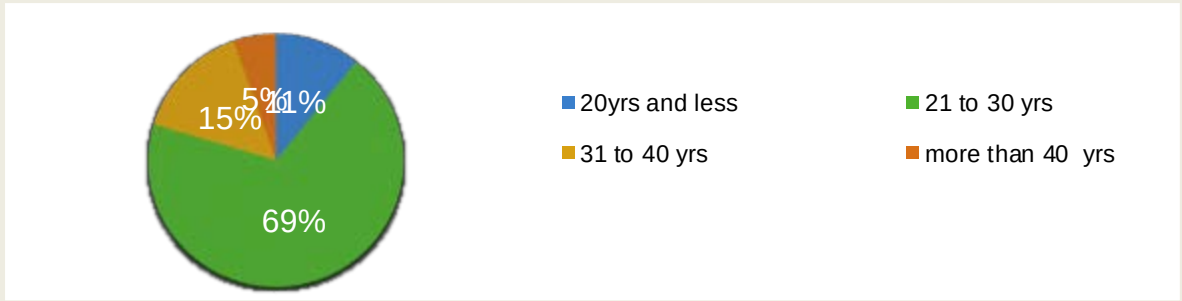


Chart 5: Age of the respondents (The author according to the research results)

The Chart 5 one can see that the greatest number of respondents is between 21 and 39 years old, even 67% of them or 165 persons. Following are the caterers of the ages between 31 and 40, or 15% of them or 36 persons. Then there are persons with less than 20 years of age, 11% or 26 persons and finally the ones of more than 40, making the 5% or 13 persons. Based on the Chart 5 one can conclude that the predominant group is the one of ages between 21 and 30 years so thaet most part of that age work in catering wile the least amount of the people working in catering belongs to the group of 40 and more years of age. Younger people dominatein this research because they are eager to prove their worth, they personalize with the company more easily and more open to new ideas. These characteristics just increase productivity of the company which consequently influences the higher competitiveness. In addition to this the success of the business depends considerably on the fact how much is the business policy based on the market orientation and in what extent they bring decisions based on the demand requests (Ružić, 2007, p. 55). Except this age structure the structure of years spent in the hospitality sector is also very important as shown in the next Chart.

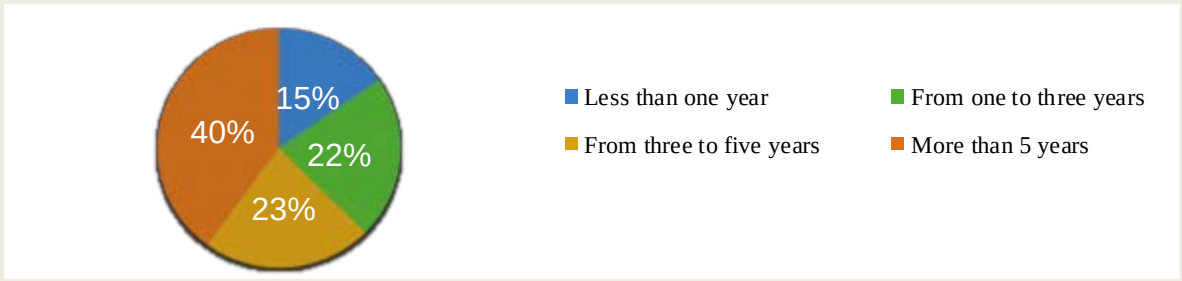


Chart 6: Years the responders spent in the hospitality service (The author according to the research results)

The Chart 6 shows how many years the responders spent in the hospitality services. One can notice that the majority have been in the services mora than 5 years, respectively 40% of them or 96 responders. They are followed by the 22% of them or 45 beeing in this service bwtween 3 to 5 years, then the 22% of them or 53 responders work in the sector from 1 to 3 years, and finally the 15% of them or 37 responders- beginners or being in the sector less than 1 year. One can also conclude that the majority of the responders possess a great work experience, namely more than 5 years so they must have run into many situations relevant to

this research. The following structure relates to the relation between motivation and a successful sale of services assuming that for the majority of people the money stimulation is the greatest motivation.

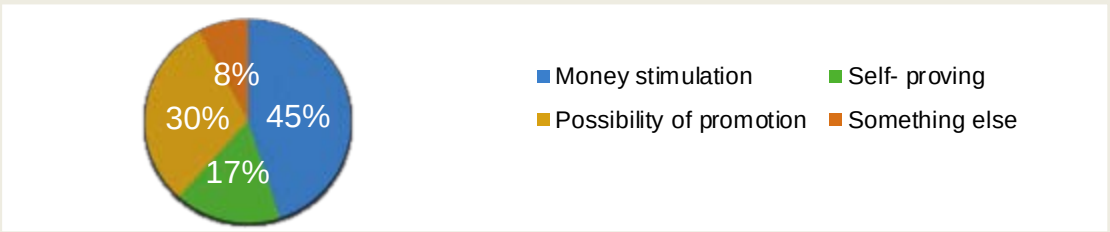


Chart 7: The greatest motivation for selling services
(The author according to the research results)

The Chart 7 shows that the majority of the responders answered that money stimulation is what mostly motivates them for a successful sale of services, namely even 108 or 45% of them, then 33% or 73 of them are of the opinion that the possibility of being promoted is their greatest motivation, then almost 17% or 40 of them thinks that the greatest motivation is self-proving, while 8% or 19 persons think that the greatest motivation is something else. Out of these 8% responders think that it is the job that has to be done in the best possible way and that a special motivation does no exist. Besides they said that it is about love for a job that matters, a wish for the company to advance, both proving to himself and the colleagues, leaving a positive impression on the guest, money stimulation and satisfied guests. A higher company productivity is achieved by motivated employees.

Chart 8: The most distinct responders' characteristics
(The author according to the research results)

The Chart 8 shows that the majority of respondents that being ambitious is the best characteristics that decribes them, namely the 37% of them or 88 respondents. Following the ambition characteristics the 32% or 77 of them considers that being optimistical is the characteristics that describes them mostly. The 28% or 68 respondents consider that being sincere is their bets characteristics while, on the other side the 3% or 7 persons are of the opinion that some other characteristics describes them the best. They consider that their most expressed characteristics is endurance, intelligence and all the named qualities.

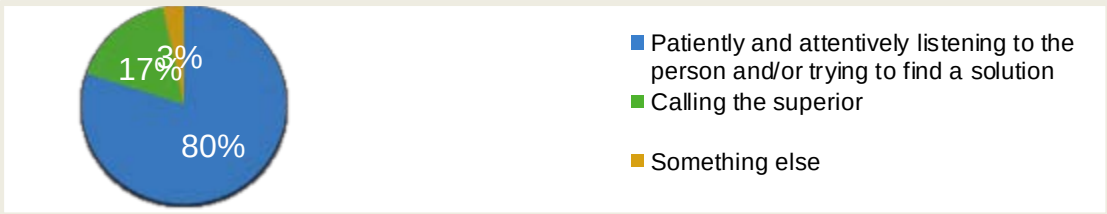


Chart 9: The way of solving the conflict situations with guests
(The author according to the research results)

The Chart 9 shows that in case of a conflict situation with a guest even 88% or 192 of respondents patiently and attentively listen to the person and tries to find a solution, the 17% or 40 of them would contact their superior to solve the problem while the 3% or 8 of them would do something else. They would try to find mutual understanding and agreement depending on the question if the guest is alcoholized and in case he caused the conflict, would not argue about but try to solve the problem by themselves with a broad smile and being amicable in case of a minor problem, but in case he would not make it he would try to solve with the superior's help. The last answer was that the responednt would try to solve the conflict alone and if without success he would give up. The successful solving of conflicts leads to repeated return of the guests, and consequently to the increase of competetiveness on the market. Further on you will find answers to the question what is the cause of conflict situations.

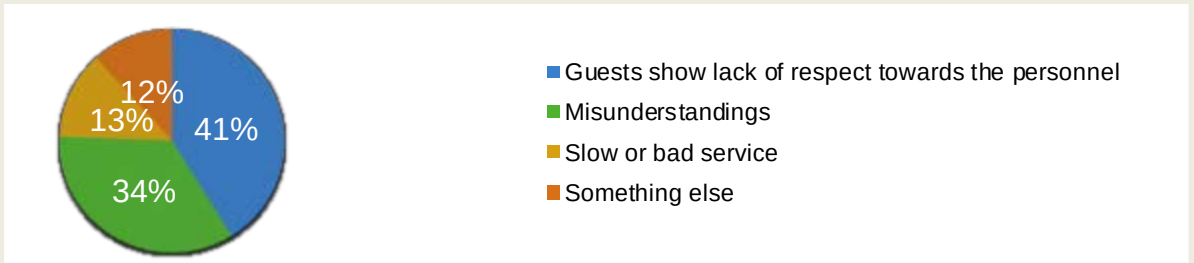


Chart 10: The reasons of beginning of conflict situations in hospitality sector (The author according to the research results)

The Chart 10 shows that 66% or 158 of the respondents think that the misunderstandings have a start of conflict situations in their job make the guests with lack of respect towards those who serve them, the 22% or 55 respondents think the misunderstandings to be the main culprit for starting the conflict situations, the 7% or the 17 of them think that the slow or bad service is the main cause of starting a conflict. 4% or 10 of the responders find the causes of conflicts to be something else. These answers point to misunderstanding with ones self, guests under the influence of alcohol, slow service and a nervous guest. In advance you will find the chart showing the greatest virtues of the respondents according to their opinion.

Chart 11: The respondents greatest virtue (The author according to research results)

The Chart 11 shows that the majority of respondents thinks that their greatest virtue is acquiesence, the 58% or 138 of them think the same of sincerety, the 17% or 40 of them is for being ambitious. Only the 3% or 6 of them considers that the wish to be the best, entering the risk and being communicative. Here is the chart showing the respondents' opinion on the question of revealing what is their greatest fault.

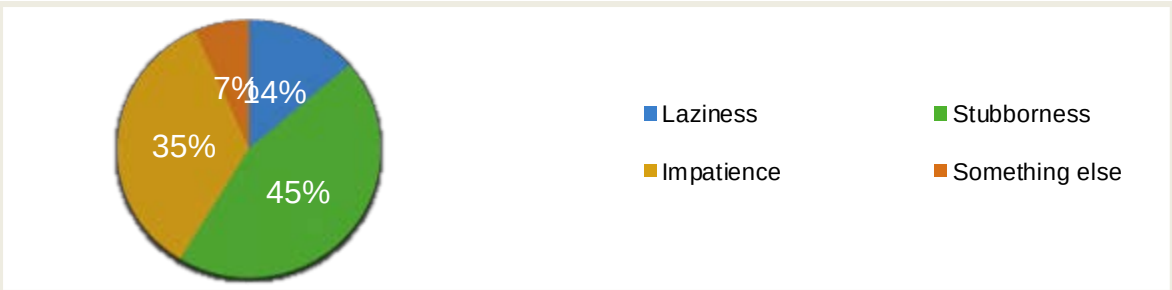


Chart 12: The greatest faults (The author according to research results)

In the Chart 12 presents that the majority of respondents, the 45% or 108 of them believe stubborness to be their greatest fault. The 35% or 83 of them consider impatiency to be their gratest fault while the 14% or 33 of them think the same of being lazy, the 7% or16 of them find themselves for being late, rash, non-professional and reckless. The next Chart relates to the situation in which a guest does not want to pay the account insisting that the service was bad as well as on the caterer's reaction to it.

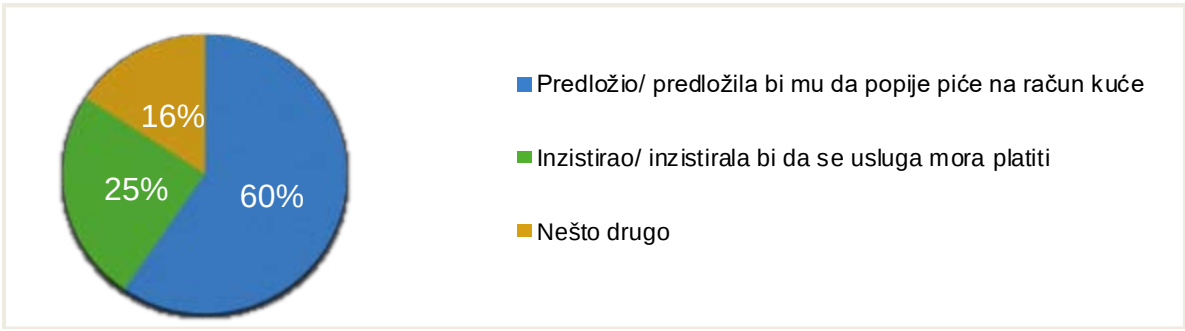


Chart 13: Situation in which a guest does not want to pay the account (The author according to the research results)

In the Chart 13 you can see that the major number of respondents, namely the 60% or 143 of them the situation when the guest did not want to pay the account, decided for a more peaceful way of offerring him a drink on the house. The 25% or 59 of them would insist that the service should be paid, while 16% or the 38 of them would react in another way. Some of the would apologize and try to leave a positive impression trying not to lose the guest. Some of them would let him to leave the place, some would talk to him, ask him not to resent and that the account will be on the house, thank him and see him off, call the superior, talk to him and try to find where the mistake is and, in case the guest appears to be right offer him another kind of item at the disposal, leave the table to the colleagues, try to find a compromise and offer a discount. The importance of verbal communication can be viewed through two perspectives; relations between employees (hotel staff) and the relationship

between customer and the stuff. (Galović, Bezić, Mišević, 2016, p. 2). In addition to this the purpose of solving the conflict situations is satisfuying the mutual interests in a way to make a treaty, reconciliation of confronted interests that appear between them. (Šlogar, Cigan, 2012, p. 260). In the following chart the first part of hypothesis is tried to be proved , stated that the caterers characteristics participate in solving the conflict situations.

Chart 14: Respondents' characteristics that mostly influence the solving of conflict situations (The author according to the research results)

The Chart 14 shows that the 50% or the 119 respondents that the most important characteristics in solving conflict situations is in fact kindness, then 30% or 71 of them think the same of inventiveness. The 11% or 27 of the respondents think that the characteristics that mostly helps in solving conflicts is sincerity, while the 5% or 13 of them think that their characteristics do not influence on the matter. The 4% or 10 of respondents consider that it is something else that influences the solving of conflicts, such as reality, being cool, patience, wisdom, all the three characteristics mentioned before, and the ability to listen and understanding. The following chart tries to prove that the second part of the hypothesis asserts that the caterers' characteristics influence the sale of services.

Chart 15: Respondents' characteristics that mostly influence the successful sale of services (The author according to the research results)

One can see from the Chart 15 that the majority of respondants think kindness to be the most influential characteristic on a successful slae of services, namely the 57% or 137 of respondents. Then 29% or 49 of them think inventiveness to be the most influential characteristic in the sale of services. The 15% or 35 of them have the opinion that frankness is the most influential characteristic while the 4% or 10 of the respondents think it is something else. Only 4% or 9 of them of the total 240 respondents think their characteristics do not influence on a successful sale of services so it drives to a conclusion that the second part of the hypothesis is confirmed considering that the rest of 96% of respondents think the

characteristics to be crucial in a successful sale of services. You can find out that out of the number of respondents who answered with something else you can see that it is about quality, kindness, creativity, being smart, generosity, combination of the three offered answers, dedication, charm and a good attitude towards the guests, being positive and being communicative.

5. CONCLUSION

Following the represented results one can say that throughout the whole research it is clearly visible that the caterers' characteristics really have a great impact in the field of their business. The hotel industry disposes with young and perspective young employees who are open to the innovations. The meet guests with various characteristics every day and many occasions of conflict situations occur caused by misunderstandings, slow or bad services and guests who show lack of respect towards them. They solve them using various methods. A majority of caterers patientla and carefully listen to the guest and try to find a solution, some of them call their superior to let him solve the conflict. On the other hand many of them suggest the guest to have a drink on the house. In this way they try to improve the business and, consequently, increase the productivity that finally as a result brings the increase of productivity. The guests prefer the interaction with cheerful, self-possessed persons with whom they may find a kind of relation in order to realize a more close contact and get some kind of confidence. In case a caterer possesses such characteristics the guest will accept his opinion in the first place in suggestions such as food or drinks choice so the waiter will sooner realize the sale je wants. He is also expected to be quick- witted in order to be able to solve the conflict situations. These results can be used in building the consciousness of the importance of caterers' characteristics in relation to successful sale of services or solving conflict situations. Keeping in mind the confirmationthat the caterers' characteristics considerably influence a successful sale of drinks, food and accommodation and any conflict situations, the companies should invest more in educationg and improvement of human potentials in order to better understand the beneficiaries of services, their wishes and needs as well as themselves to create an additional value to the hospitability in bigger income, profit and higher efficiency in the business itself.

ACKNOWLEDGEMENT: *This work been supported in part by the University of Rijeka under the project number 16.02.2.2.01 and 13.02.1.3.13.*

LITERATURE:

1. Cerović, Z. (2003). *Hotelski menadžment*, Opatija: Fakultet za hotelski i turistički menadžment.
2. Cicvarić, A. (1990). *Ekonomika turizma*, Zagreb: Zagreb poduzeće za grafičku djelatnost.
3. Galović, T., Bezić, H., Mišević, P. (2016). *Verbal communication in the export of services in the Republic of Croatia*, Proceedings of The International Scientific Conference
4. *Gospodarska kretanja* (2013-2017). HGK. Retrieved 10.05.2017. from http://www.hgk.hr/search?search=gospodarska%20kretanja
5. *Image brosura Hrvatka puna života: Ne ispunjavajte život danima, ispunite dane životom (2017).* Retrieved 22.03.2017. from http://www.htz.hr/sites/default/files/2017-01/ImageBrosura%20HTZ-HRV-online.pdf
6. Križman- Pavlović, D. (2008). *Marketing turističke destinacije*, Zagreb: Mikorad.

7. *Mjesečni statitički bilten*. (2017). Retrieved 18.05.2017 from http://www.hzz.hr/default.aspx?id=10052
8. Ružić, D. (2007). *Marketing u turističkom ugostiteljstvu*, Osijek: Ekonomski fakultet Osijek.
9. Statitičke informacije Hrvatskog zavoda za mirovinsko osiguranje. (2017). Retrieved 18.05.2017 from http://www.mirovinsko.hr/default.aspx?id=10433
10. Šlogar, H., Cigan, V. (2012). Umijeće pregovaranja kao ključna kompetencija u razvoju poduzetništva, Retrieved 10.05.2017. from http://hrcak.srce.hr/130274
11. Cvrtila V. (2012), Sirija i Libija: što ih povezuje, a što dijeli? *Političke analize*, 2012 (Vol.3 No.12) Retrieved 10.05.2017 from http://hrcak.srce.hr/142024

EMPLOYEE ENGAGEMENT BY GALLUP IN SLOVENIAN COMPANIES

Katja Crnogaj
Faculty of Economics and Business, University of Maribor, Slovenia
katja.crnogaj@um.si

Maja Rozman
Faculty of Economics and Business, University of Maribor, Slovenia
maja.rozman@student.um.si

ABSTRACT

According to Gallup Leadership Institute studies and some other authors, employee engagement is a significant predictor of desirable organizational outcomes. Indeed, firm performance is neither a self-evident phenomenon nor a matter of chance. Rather, it is the result of organizational environment that affects worker's quality of life and performance. Exploring issues and challenges facing employee engagement may offer valuable insights into promoting well-being approach to understand the well-being of workers. Research paper investigates employee engagement in Slovenian companies. Our fundamental research question is: Are employees in Slovenian companies engaged on their workplace? Approximate 400 randomly selected employees in Slovenian companies are included in the sample. We used a focused Gallup employee survey consisting of 12 statements evolved from a number of qualitative and qualitative studies. These 12 statements are asked with five-response options (1=strongly disagree, 5=strongly agree). The answers are processed with descriptive statistics. The findings provide evidence of considerable heterogeneity among Slovenian companies and better understanding of this phenomenon could be very interesting for those owners and managers who spend substantial resources hiring employees and trying to generate products, profits, and maintain loyal customers, for those interested in propitiating a reactivation and a new size for their companies in a short time, as well as for public administrations and governments interested in generating new employment in order to design support policies to improve growth and innovation rates of companies. Finally, we explored the implications that the findings may have for effective owners/management development and practice.

Keywords: *Employees, Gallup, Slovenian companies, Work engagement*

1. INTRODUCTION

Employee engagement in the workplace is an important and complex topic in today's business world. Engaged employees represents a positive and energetic connection with work, they have a high level of energy, are more successful, productive, motivated, satisfied and committed. There are many reasons why engaged employees perform better than non-engaged employees. Engaged employees often experience positive emotions, they are in better health and finally show better business results. According to Schaufeli and Bakker (2004) work engagement is an affective-motivational, work-related state of fulfillment in employees that is characterized by vigor, dedication and absorption. Research from authors Salanova et al. (2005), Schaufeli et al. (2006), Xanthopoulou et al. (2009) have indicated that work engagement related positively to customer satisfaction, in-role performance, and financial returns. Engaged employees describe their tiredness as a rather pleasant state because it is associated with positive accomplishments and they are not addicted to their work. They enjoy other things outside work and, unlike workaholics, they do not work hard because of a strong and irresistible inner drive, but because for them working is fun. Work

engagement is an important indicator of occupational well-being for both employees and companies. Thus, company can do several things to facilitate work engagement among their employees (Bakker, Demerouti, 2008). This study will aim to add to the literature on employee engagement by examining Slovenian companies to help better understand the attributes associated with companies' performance. In this paper we present the importance of work engagement in Slovenian companies. The findings will provide evidence of considerable heterogeneity among Slovenian companies and better understanding of this phenomenon could be very interesting for those owners and managers who spend substantial resources hiring employees and trying to generate products, profits, and maintain loyal customers, for those interested in propitiating a reactivation and a new size for their companies in a short time as well as for public administrations and governments interested in generating new employment in order to design support policies to improve growth and innovation rates of companies. This paper aims to answer the following research question: (1) RQ1: Are employees in Slovenian companies engaged on their workplace?

2. LITERATURE REVIEW

2.1. Engagement employee in the workplace

Engaged employees have a sense of energetic and affective connection with their work activities (Gorgievski et. al., 2014). Bakker et al. (2008) assert that engaged individuals work hard, are involved and feel happily engrossed in their work. Engaged employees experience vitality, flow, and fun while working and work fulfills important psychological needs (Gorgievski et. al., 2014).

Work engagement is defined as a positive, fulfilling, work-related state of mind that is characterized by vigor, dedication, and absorption (Schaufeli et al., 2002). Authors Bakker and Demerouti, (2008) summarize that vigor is characterized by high levels of energy and mental resilience while working. Dedication refers to being strongly involved in one's work and experiencing a sense of significance, enthusiasm, and challenge. Further, absorption is characterized by being fully concentrated and happily engrossed in one's work, whereby time passes quickly and one has difficulties with detaching oneself from work. Thus, engaged employees have high levels of energy and are enthusiastic about their work. Moreover, they are often fully immersed in their work so that time flies.

An engaged employee is a person who is fully involved in, and enthusiastic about, his or her work. Engaged employees are attracted to, and inspired by, their work ("I want to do this"), committed ("I am dedicated to the success of what I am doing"), and fascinated ("I love what I am doing"). Engaged employees care about the future of the company and are willing to invest the discretionary effort (Seijts, Crim, 2006).

2.2. The positive consequences of work engagement

According to Bakker (2009) engaged workers perform better than non-engaged workers. Banihani et al. (2013) summarize from other authors four reasons that make engaged workers perform better than non-engaged workers: (1) engaged workers experience positive emotions such as happiness, enthusiasm, and joys; (2) they have better health; (3) they are able to create their own job and personal resources and (4) they often transfer their engagement to others. Moreover, work engagement has been positively associated with psychological resources (such as general self-efficacy), life satisfaction, and good social relationships at work (Taris et al., 2009). There is positive relationship between work engagement and numerous relevant firm outcomes. For example, a meta-analysis by Harter et al. (2002) found that engagement was positively related to customer satisfaction, loyalty, profitability, employee turnover and productivity. Employee engagement also affects the mindset of people. Engaged employees believe that they can make a difference in the organizations they

work for. Confidence in the knowledge, skills, and abilities that people possess – in both themselves and others – is a powerful predictor of behavior and subsequent performance. Thus, consider some of the results of research (Seijts, Crim, 2006):

- 84 percent of highly engaged employees believe they can positively impact the quality of their organization's products, compared with only 31 percent of the disengaged.
- 72 percent of highly engaged employees believe they can positively affect customer service, versus 27 percent of the disengaged.
- 68 percent of highly engaged employees believe they can positively impact costs in their job or unit, compared with just 19 percent of the disengaged.

Given these data, it is not difficult to understand that companies that do a better job of engaging their employees do outperform their competition. Employee engagement can not only make a real difference, it can set the great organizations apart from the merely good ones (Seijts, Crim, 2006).

2.3. Work engagement by Gallup

Employee engagement will become an increasingly important concern for countries and organizations seeking to boost labor productivity as the global economy continues its rapid pace of change. The companies most successful at engaging their employees bring the conversation of engagement into the workplace every day. It is important before organizations begin measuring engagement to communicate the reasons behind this strategic goal and the advantages for the company and the employees themselves. Regular communication from the company's leaders and informal communication between employees will begin to breed a culture of engagement, leading participation rates of employee engagement metrics and other interventions to be more successful. Vital to maintaining high-productivity workplaces is organizations' ability to engage their employees. Gallup's extensive research shows that employee engagement is strongly connected to business outcomes such as productivity, profitability, and customer satisfaction. Those are essential to an organization's financial success. However, according to Gallup's latest findings, 87% of workers are "not engaged" or "actively disengaged" and are emotionally disconnected from their workplaces and less likely to be productive. The proportion of actively disengaged employees has decreased from 27% to 24%. Work of employees is more often a source of frustration than one of fulfillment. It also means countless workplaces worldwide are less productive and less safe than they could be and are less likely to create badly needed new jobs. Therefore, business leaders worldwide must raise the bar on employee engagement. Increasing workplace engagement is vital to achieving sustainable growth for companies, communities, and countries - and for putting the global economy back on track to a more prosperous and peaceful future (Gallup, 2013). Based on employees responses to the 12 items, Gallup groups them into one of three categories: engaged, not engaged, and actively disengaged. Not engaged workers can be difficult to spot: They are not hostile or disruptive. They show up and kill time with little or no concern about customers, productivity, profitability, waste, safety, mission and purpose of the teams, or developing customers. They are thinking about lunch or their next break. They are essentially "checked out." Surprisingly, these people are not only a part of your support staff or sales team, but they are also sitting on your executive committee. Actively disengaged employees are more or less out to damage their company. They monopolize managers' time; have more on-the-job accidents; account for more quality defects; contribute to "shrinkage," as theft is called; are sicker; miss more days; and quit at a higher rate than engaged employees do. On the other hand, engaged employees are the best colleagues. They cooperate to build an organization, institution, or agency, and they are behind everything good that happens there. These employees are

involved in, enthusiastic about, and committed to their work. They know the scope of their jobs and look for new and better ways to achieve outcomes. They are 100% psychologically committed to their work. And, they are the only people in an organization who create new customers (Gallup, 2013).

3. METHODOLOGY

The focus of our research is on Gallup's Q12 instrument. In short, the development of the GWA (Q12) was based on more than 30 years of accumulated quantitative and qualitative research. Its reliability, convergent validity, and criterion-related validity have been extensively studied. It is an instrument validated through prior psychometric studies as well as practical considerations regarding its usefulness for managers in creating change in the workplace. In designing the items included in the Q12, researchers took into account that, from an action-ability standpoint, there are two broad categories of employee survey items: those that measure attitudinal outcomes (satisfaction, loyalty, pride, customer service intent, and intent to stay with the company) and those that measure actionable issues that drive the above outcomes. The Q12 measures the actionable issues for management — those predictive of attitudinal outcomes such as satisfaction, loyalty, pride, and so on (Gallup, 2006). The Q12 statements in our research from Gallup are: Q01. I know what is expected of me at work; Q02. I have the materials and equipment I need to do my work right; Q03. At work, I have the opportunity to do what I do best every day; Q04. In the last seven days, I have received recognition or praise for doing good work; Q05. My supervisor, or someone at work, seems to care about me as a person; Q06. There is someone at work who encourages my development; Q07. At work, my opinions seem to count; Q08. The mission or purpose of my company makes me feel my job is important; Q09. My associates or fellow employees are committed to doing quality work; Q10. I have a best friend at work; Q11. In the last six months, someone at work has talked to me about my progress; Q12. This last year, I have had opportunities at work to learn and grow. To determine the engagement of employees in the workplace, the employees indicated on a a five-point scale, where "5" is extremely satisfied and "1" is extremely dissatisfied. The sample will include approximate 400 randomly selected employees in Slovenian companies. We used descriptive statistics for answers about the work engagement of Slovenian employees. Questionnaires were sent to small, medium-sized and large Slovenian companies in 2017. Companies were selected randomly. The sample consists of 400 employees. Table 1 shows the profile of respondents and control variables.

Table 1: Profile of respondents and control variables – (Ends on the next page)

Characteristic of respondents		Number of respondents	Percentage
Age	18 to 49 years	195	48.8%
	50 to 65 years	205	51.2%
Level of achieved education	Vocational or secondary school	68	17%
	High school	132	33%
	University education	179	44.7%
	Masters degree or doctorate	21	5.3%
Region where respondents performs their job	The region of Pomurje	27	6.8%
	The region of Podravje	86	21.5%
	The region of Koroška	13	3.2%
	The region of Savinjska	18	4.5%

Region where respondents performs their job	The region of Zasavska	16	4%
	The region of Posavska	11	2.7%
	The region of South-east Slovenia	44	11%
	The region of Central Slovenia	134	33.6%
	The region of Gorenjska	18	4.5%
	The region of Primorsko-notranjska	12	3%
	The region of Goriška	10	2.5%
	The region of Coastal-Kras	11	2.7%
Size of companies in which respondents are employed	Large company	99	24.7%
	Medium-sized company	221	55.3%
	Small company	80	20%

4. RESULTS

Table 2 presents answers about the employee engagement on the workplace in Slovenian companies. Table 3 presents descriptive statistics for answers about the work engagement of employees on their workplace.

Table2: Answers about the employee engagement on the workplace in Slovenian companies (Ends on the next page)

The Q12 statements		**Answers**					**The number of units**
		Strongly disagree 1	Disagree 2	Neither agree or Disagree 3	Agree 4	Strongly agree 5	
Q1	I know what is expected of me at work.	0 (0%)	11 (3%)	112 (28%)	252 (63%)	25 (6%)	400 (100%)
Q2	I have the materials and equipment I need to do my work right.	0 (0%)	8 (2%)	282 (71%)	100 (25%)	10 (3%)	400 (100%)
Q3	At work, I have the opportunity to do what I do best every day.	1 (0%)	127 (32%)	184 (46%)	83 (21%)	5 (1%)	400 (100%)
Q4	In the last seven days, I have received recognition or praise for doing good work.	10 (3%)	64 (16%)	207 (52%)	119 (30%)	0 (0%)	400 (100%)
Q5	My supervisor, or someone at work, seems to care about me as a person.	5 (1%)	7 (2%)	291 (73%)	95 (24%)	2 (1%)	400 (100%)
Q6	There is someone at work who encourages my development.	1 (0%)	11 (3%)	294 (74%)	83 (21%)	11 (3%)	400 (100%)
Q7	At work, my opinions seem to count.	0 (0%)	8 (2%)	178 (45%)	182 (46%)	32 (8%)	400 (100%)

Q8	The mission or purpose of my company makes me feel my job is important.	1 (0%)	5 (1%)	112 (28%)	263 (66%)	19 (5%)	400 (100%)
Q9	My associates or fellow employees are committed to doing quality work.	0 (0%)	10 (3%)	106 (27%)	251 (63%)	33 (8%)	400 (100%)
Q10	I have a best friend at work.	1 (0%)	22 (6%)	309 (77%)	67 (17%)	1 (0%)	400 (100%)
Q11	In the last six months, someone at work has talked to me about my progress.	9 (2%)	88 (22%)	241 (60%)	59 (15%)	3 (1%)	400 (100%)
Q12	This last year, I have had opportunities at work to learn and grow.	2 (1%)	30 (8%)	211 (53%)	150 (38%)	7 (2%)	400 (100%)

Table 2 shows that employees agree with statement Q1 (I know what is expected of me at work); Q7 (At work, my opinions seem to count); Q8 (The mission or purpose of my company makes me feel my job is important) and Q9 (My associates or fellow employees are committed to doing quality work).

Table 3: Descriptive statistics for answers about the work engagement of employees on their workplace – (Ends on the next page)

	The Q12 statements	**The number of units**	**Average**	**Standard deviation**	**Minimum**	**Maximum**
Q1	I know what is expected of me at work.	400	3.7	0.62	2	5
Q2	I have the materials and equipment I need to do my work right.	400	3.3	0.54	2	5
Q3	At work, I have the opportunity to do what I do best every day.	400	2.9	0.76	1	5
Q4	In the last seven days, I have received recognition or praise for doing good work.	400	3.1	0.74	1	4
Q5	My supervisor, or someone at work, seems to care about me as a person.	400	3.2	0.53	1	5
Q6	There is someone at work who encourages my development.	400	3.2	0.55	1	5
Q7	At work, my opinions seem to count.	400	3.6	0.67	2	5
Q8	The mission or purpose of my company makes me feel my job is important.	400	3.7	0.56	1	5
Q9	My associates or fellow employees are committed to doing quality work.	400	3.8	0.63	2	5
Q10	I have a best friend at work.	400	3.1	0.48	1	5

Q11	In the last six months, someone at work has talked to me about my progress.	400	2.9	0.69	1	5
Q12	This last year, I have had opportunities at work to learn and grow.	400	3.3	0.66	1	5

Table 3 shows that on average employees know what is expected of them at work, at work their opinions seem to count, the mission or purpose of their company makes their feel that their job is important and their associates or fellow employees are committed to doing quality work. In the other cases on average, employees neither agree nor disagree with following statements: I have the materials and equipment I need to do my work right (Q2); At work, I have the opportunity to do what I do best every day (Q3); In the last seven days, I have received recognition or praise for doing good work (Q4); My supervisor, or someone at work, seems to care about me as a person (Q5); There is someone at work who encourages my development (Q6); I have a best friend at work (Q10); In the last six months, someone at work has talked to me about my progress (Q11); This last year, I have had opportunities at work to learn and grow (Q12).
Based on the results we can conclude that employees in Slovenian companies are not sufficient engaged on their workplace.

5. DISCUSSION AND CONCLUSION

Our research shows that on average employees faced with the problem of engagement in the workplace in Slovenian companies. Disengaged employees are discontent and negative, they generate less added value, lower productivity and higher turnover rate. The problem of disengaged employees is also present in other countries. For example, Gallup's (Gallup, 2016) latest measure of employee engagement in Germany found that 16% of workers are engaged in their jobs, or emotionally and behaviorally connected to their job and company. The majority are not engaged (68%), which means they aren't putting energy or passion into their work. And 16% are actively disengaged, meaning they are more or less out to do damage to their company. The percentage of actively disengaged employees had previously declined; it was 24% in 2012, and then dropped to 17% in 2013 and to 15% in 2014, before edging up in 2015. The study included 1.429 employed adults from Germany.
Companies must show that they value employees. They also must allow employees a balance between work and private life, provide opportunities for career advancement, they must communicate a clear vision (employees need to understand what the organization’s goals are, why they are important, and how the goals can best be attained), they also must create an environment that fosters trust and collaboration, take care to/for reward and motivate employees at work and the most important is, that they care for friendly working environment for their employees. However, if employees’ relationship with their managers or boss is fractured, then no amount of perks will persuade employees to perform at top levels. Employee engagement is a direct reflection of how employees feel about their relationship with the boss. It is important to know that not giving people the knowledge and tools to be successful is unethical and de-motivating, it is also likely to lead to stress, frustration, and, ultimately, lack of engagement. Engaged employees support the innovation, growth and revenue that their companies need. According to Gallup (2013) when employees feel engaged and productive at work, it positively affects their lives at work and beyond the workplace as well. Engaged employees assess their overall lives more highly than not engaged or actively disengaged employees. They also report more positive day-to-day emotional states and interactions with others than their less engaged peers.

LITERATURE:

1. Bakker, A.B. (2009). Building engagement in the workplace. In Burke, R.J. and Cooper, C.L. (Eds), *The Peak Performing Organization*, Routledge, Oxon, pp. 50-72.
2. Bakker, A.B., Demerouti, E. (2008).Towards a model of work engagement. *Career Development International*, Vol. 13 Iss 3 pp. 209 – 223
3. Bakker, A.B., Schaufeli, W.B., Leiter, M.P. and Taris, T.W. (2008). *Work engagement: an emerging concept in occupational health psychology*. Work & Stress, Vol. 22, pp. 187-200.
4. Banihani, M., Lewis, P., Syed, J. (2013). Is work engagement gendered? *Gender in Management: An International Journal*, Vol. 28 Iss 7 pp. 400 – 423
5. Gallup, G. (2013). *State of the Global Workplace. Employee Engagement Insights for business leaders worldwide*. Retrieved on 27/04/2017 from the website: http://www.securex.be/export/sites/default/.content/download-gallery/nl/brochures/Gallup-state-of-the-GlobalWorkplaceReport_20131.pdf
6. Gallup, G. (2016). *The Negative Impact of Disengaged Employees on Germany*. Retrieved on 09/05/2017 from the website: http://www.gallup.com/businessjournal/190445/negative-impact-disengaged-employees-germany.aspx
7. Gallup, G. workplace audit – The Gallup Q12. (2006). *Q12 Meta-Analysis* . Retrieved on 25/04/2017 from the website: https://strengths.gallup.com/private/resources/q12meta-analysis_flyer_gen_08%2008_bp.pdf
8. Gorgievski, M.J., Moriano, J.A., Bakker, A.B. (2014). Relating work engagement and workaholism to entrepreneurial performance. *Journal of Managerial Psychology*, Vol. 29 Iss 2 pp. 106 – 121
9. Harter, J.K., Schmidt, F.L. and Hayes, T.L. (2002). Business-unit-level relationship between employee satisfaction, employee engagement, and business outcomes: a meta-analysis. *Journal of Applied Psychology*, Vol. 87 No. 2, pp. 268-279.
10. Salanova, M., Agut, S., & Peiró, J. M. (2005). Linking organizational resources and work engagement to employee performance and customer loyalty: The mediation of service climate. *Journal of Applied Psychology*, 90, pp. 1217–1227.
11. Schaufeli, W. B., Bakker, A. B. (2004). Job demands, job resources, and their relationship with burnout and engagement: A multi-sample study. *Journal of Organizational Behavior*, 25, pp. 293–315
12. Schaufeli, W. B., Taris, T. W., Bakker, A. B. (2006). Dr. Jeckyll and Mr. Hyde: On the differences between work engagement and workaholism. In R. J. Burke (Ed.), *Research companion to working time and work addiction* (pp. 193–217). Northhampton, UK: Edward Elgar
13. Schaufeli, W.B., Salanova, M., Gonza´lez-Roma´, V, Bakker, A.B. (2002). The measurement of engagement and burnout and: a confirmative analytic approach. *Journal of Happiness Studies*, Vol. 3, pp. 71-92.
14. Seijts G., Crim, D. (2006). *What Engages Employees the Most OR, the Ten Cs of Employee Engagement*. Richard Ivey School of Business Foundation
15. Taris, T.W., Schaufeli, W.B. and Shimazu, A. (2009). The push and pull of work: the differences between workaholism and work engagement. In Bakker, A.B. and Leiter, M.P. (Eds), *Work Engagement: A Handbook of Essential Theory and Research, Psychology Press*, New York, NY, pp. 39-53.
16. Xanthopoulou, D., Bakker, A. B., Demerouti, E., Schaufeli, W. B. (2009). Work engagement and financial returns: A diary study on the role of job and personal resources. *Journal of Occupational and Organizational Psychology*, 82, pp. 183–200.

COLLABORATIVE ECONOMY – CHALLENGE FOR REGULATORS

Kosjenka Dumancic
Faculty of Economics and Business, University of Zagreb, Croatia
kdumancic@efzg.hr

ABSTRACT
Collaborative economy presents business model which activities promote platforms for collaboration that create an open market for temporary use of the goods or services and which are often provided by private persons. From the first basic idea of sharing economy as with no economic benefit the collaborative economy has grown, based on fast development of digitalisation and platforms, to the high impact industry. Collaborative economy represents a challenge for regulators. The fast development of digital platforms cannot be followed on the adequate way providing legal certainty and legal surrounding. The collaborative economy opens up a large scale of legal issues that need to be regulated at the national and supra-national levels. The idea of regulation at the level of European Union is based at the European Commission initiative, which is stressed in its Communication. When discussing the regulation it should be stressed that the regulation sometimes can have counterproductive effects on developing new possibilities. In the case of collaborative economy, where the consumers are actively participating in evaluation process, the service is directly connected with their evaluation. Sometimes, by regulation innovation can also decline. The Internet and digitalisation open up a possibility where consumer welfare can be better served by innovation and competition than by the regulation. The paper will examine different approaches for the regulation in collaborative economy and give a short overview on different legal issues which have to be examined by the regulators.
Keywords: *Collaborative economy, Consumer protection, EU law**,** regulation*

1. INTRODUCTION

The collaborative economy is considered as one of the fastest growing trend at goods and services market in this decade. The Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions titled A European Agenda for the collaborative economy (COM (2016) 356 final) from 2nd June 2016 (further: EC Agenda) defines collaborative economy as the business models where activities are facilitated by collaborative platforms that create an open marketplace for the temporary use of goods or services often provided by the private individuals. This phenomenon is also known as the sharing economy, demand economy, peer-to-peer economy, "gig" economy and in all cases the common characteristic is that this is a way of offering and use products and services through online platform. According to De Stefano, usually these economies are understood as to include two forms of work: "crowdwork" and "work on demand via apps" (Cardon and Casilli, 2015; De Stefano, 2016). The work on demand via apps is related to the traditional working activities that are offered and assigned through the mobile applications (De Stefano, 2016) like transport, cleaning and running errands is channelled through apps managed by firms that also intervene in setting minimum quality standards of service and in the selection and management of the workforce. The collaborative economy is growing rapidly and it takes root in European Union. At the same time national and local authorities are responding with patchwork of different regulatory actions (EC Agenda).

From the name itself it is obvious that the idea is to establish economic surroundings from which all the participants should benefit. This article examines the situations which are connected to economic benefit for subjects that are participating in this form of work and not

the form where the subjects are collaborating in order to gather with no economic impact such as in different living communities or communities with charitable purposes.

How is the collaborative economy realized? The historical background of the sharing economy can be reached in works of Hirschman (The Rhetoric of Reaction, 1991) and Murray (Loosing Ground, 1984) that analyses the question of „gig" workers who participate in particular work at the digital market for the »pocket money«. The idea was defined in fifties and sixties years of the past century in connection with establishment of the first agencies for the temporary employment in US (Berg, 2016). The main idea was to provide services or goods by »peers« with the goal to share resources with no profit.

When analyzing collaborative economy, the Communication »A European Agenda for the collaborative economy« defines three categories of participants: service providers (who share assets, resources, time and/or skills — these can be private individuals offering services on an occasional basis (»peers«) or service providers acting in their professional capacity (»professional services providers«); users of these; and intermediaries that connect - via an online platform - providers with users and that facilitate transactions between them (»collaborative platforms«).

As defined by the Agenda, collaborative economy transactions generally do not involve a change of ownership and can be carried out for profit or not-for-profit. When speaking about the change of ownership, it was the change in understanding the ownership that increased the possibility of collaborative economy. Instead of owning, consumers want to access to goods and prefer to pay for the experience of temporarily accessing them. Ownership is no longer the ultimate expression of consumer desire (Chen, 2009). In this way, the consumers are enabled to access objects or networks that they could not afford to own or they choose not to own due to the concerns such as space constraints or the environment (Bardhi and Eckhardt, 2012).

In legal sense this division of actors will have to be the cornerstone for defining mutual rights and obligations between collaborative economy participants. Also, bearing in mind the freedom to provide services at the EU internal market, the economic character of the service, respectively its compensation, is the main characteristic of the service that classifies it in the area of the free provision of services in the context of free movement at the EU internal market (Barnard, 2007; Craig, de Burca, 2008; Horak, Bodiroga-Vukobrat, Dumančić, 2015).

European Commission recognized this form of doing business as a potential area that is small but growing rapidly, gaining important market shares in some sectors. Gross revenue in the EU from collaborative platforms and providers was estimated to be EUR 28 billion in 2015. Revenues in the EU in five key sectors almost doubled compared with the previous year and are set to continue expanding robustly. It is estimated that collaborative platforms operating in five key sectors of the collaborative economy generated revenues of EUR 3.6 bn in 2015 in the EU: accommodation (short-term letting); passenger transport; household services; professional and technical services, and collaborative finance. (All figures are based on estimates of PwC Consulting as part of a study contracted by the European Commission.) The growth has been strong since 2013 and accelerated in 2015 as large platforms invested significantly in expanding their European operations. Going forward, some experts estimate that the collaborative economy could add EUR 160-572 billion to the EU economy. Therefore, there is a high potential for new businesses to capture these fast growing markets. (EPRS: The cost of non-Europe in the Sharing Economy, 2016.)

The importance of collaborative economy is confirmed and apparent from the data analysis at the world level. Till June 2015, there were 17 companies in this area worth more than 1 billion US dollars. Twelve of them were incorporated in the US, while only one company was incorporated in EU (TransferWise that is incorporated in Great Britain). The two most popular, Uber and Airbnb, according to the data available from the Austin and Al. (2015) and

Bloomberg (2015) Reports, are worth between 40 and 50 billion US dollars (Uber between 10 and 20 billion US dollars, and Airbnb, according to the newest data from Bloomberg (available at http://graphics.wsj.com/billion-dollar-club/)). Uber is worth 68 billion US dollars and Airbnb is worth 30 billion. According to the Eurobarometer research, 52% the EU citizens are aware of the provision of services by collaborative economy and 17% of the EU citizens used this kind of service at least once in their life. According to PwC (2015), the sharing inducted by commercial peer-to-peer systems generates a volume of business estimated at $30 billion through more than 9000 start-ups across the world. Between now and 2025 this amount is expected to multiply eleven times over and reach $335 billion in 2025 (Marchi and Parekh, 2015; Ertz, Lecompte, Duif, 2016).
All these data clearly accentuate the importance of the sharing economy worldwide.

2. PROS AND CONS OF THE COLLABORATIVE ECONOMY

The increasing frequency of use of services provided at lower prices is underlined as the main advantage of the collaborative economy (De Stefano, 2016). According to the EC Agenda, collaborative economy opens up new possibilities for consumers and businesses and is also a challenge for the existing market participants as well as business practices. New business models based on innovation have considerable potential to increase competitiveness and growth, and by allowing individual participants to provide services thus creating new opportunities for employment, flexible working conditions and new revenue streams. Collaborative economy may help consumers to find new services, expanded supply and lower prices. It can encourage the further sharing and efficient use of resources (Ertz, Lecompte, Durit, 2016).
At the same time, the rapid development raised the issue of application of the existing legal framework, in which the current boundaries between consumers and service providers, employees and self-employed person or the provision of professional and non-professional services disappear (EC Agenda, pp.2). This can result in uncertainty over applicable rules, especially when combined with regulatory fragmentation stemming from divergent regulatory approaches at national or local level (De Stefano, 2016). This hampers the development of the collaborative economy in Europe and prevents its benefits to materialise fully. At the same time, there is a risk that regulatory grey zones are exploited to circumvent rules designed to preserve the public interest (EC Agenda, pp.2).
The legal framework regulating the sharing economy will have to take into account all the specifics of this kind of business and legal relationships that arise within it. It is the absence of the legal framework that raises many disputes caused by the fact that there is neither defined responsibility nor the rights of all the participants. The regulation should call into the question the traditional commercial, economic, fiscal and legislative order in accordance with consumers and commercial enterprises that were traditionally clearly separated, with distinctly different roles regulated by the governmental institutions (Perret, 2004; Ertz, Lecompte, Durit, 2016). The regulation in question will have to step out from this traditional distinction. Other negative aspects are trust and reliability in service providers, having as a fundamental problem highlight the confidence in conducting transactions over the Internet, which is cited as a major drawback of these platforms. The most relevant rules on contractual and extra-contractual liability are laid down in national legislation. The general rules under EU law regarding online platforms, as providers of information society intermediary services are under certain conditions exempted from liability regarding the information they store, are defined by the 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, pp. 1–16) (Agenda, p. 7.).

3. REGULATORY FRAMEWORK FOR THE COLLABORATIVE ECONOMY

Collaborative economy has been developed in order to satisfy service providers as well as consumers. The collaborative economy and its regulation have become highly charged policy topics, especially at the local level. Local governments are attempting to impose older regulatory regimes on these new services without having much thought on whether they are still necessary to protect consumer welfare as it was the main rationale for economic regulation through the time (Lehrer, Moylan, 2014; Koopman, Mitchell, Thierer, 2015).

Most often consumers rate service and providers and thus create their own criteria that serve as a measure of protection for other consumers. In this regard, the issue of regulatory boundaries is raised, i.e. whether it is necessary to regulate all the segments or let it to the self-regulation, since, as a rule, regulation affects the limitation of development and innovation (Koopman, Mitchell, Thierer, 2015; Cohen, Sundararajan, 2015).

The rapid development of this kind of business contributes to its regulation (Ertz, Lecompte, Durit, 2016; Zuluaga, 2016). The Communication from the Commission: Upgrading the Single Market: more opportunities for people and business (Brussels, 10.28.2015. COM (2015) 550 final. Further: The Single Market Strategy) adopted in October 2015 by the European Commission announces the "European agenda for the collaborative economy, including guidance on how existing EU law applies to collaborative economy business models. It will assess possible regulatory gaps and monitor the development of the collaborative economy" (pp. 4). In addition to being a part of the Single Market Strategy the collaborative economy represents a part of the Communication from the Commission: Strategy for Digital Single Market for Europe (Brussels, 6.5.2015. COM (2015) 192 final. Further: Digital Single Market Strategy).

It is emphasized that support to the collaborative economy is the key to achieving the goals of a single digital market by providing better access for consumers and doing business with goods and services that are offered through the Internet in the European Union. It is considered that the activities of the European Commission will contribute to ensuring the efficient provision of services, re-use of existing factors of production and will provide new and flexible framework for employment. The reason is that new business models affect the existing business by encouraging competition and changing consumer behaviour (Codagnone, Abadie, Biagi, 2016).

In legal context, the collaborative economy opens up a number of issues. A relatively slow adoption of the regulatory framework at European and national level cannot follow the rapid digitization and technology development. In this context, the EU regulatory framework is based on the communications of the European Commission and the case-law of the Court of Justice of the European Union. In this regard, several proceedings are pending at the moment at the Court of Justice of the European Union. The issue concerned is to determine the character of taxi services by applying the rules on free movement at the Internal market with respect to the freedom to provide services through the platforms that support the collaborative economy (proceedings before the Court European Union in cases C-526/15 Uber Belgium BVBA in Taxi Radio Bruxellois NV; C-320/16 Criminal proceedings against Uber France SAS and others). The collaborative economy contributes to the creation of new and expansion of existing markets and it applies to those participants who have not offered their services as professional traders before, regardless of whether the service is provided online or in the traditional manner. This expansion actually implies specific ways of providing services with the platform that serves to connect and interfere between the providers and recipients of services. Given that in any case this business can be considered as an economic activity, since the service providers receive the compensation, the EU law governing the freedom to provide services applies (Horak, Bodiroga-Vukobrat, Dumančić, 2015; Horak, Bodiroga-Vukobrat, Dumančić, 2014).

3.1. Collaborative economy when the service is provided by professionals

When we consider the professional services, it should be noted that legislation at the national level is not uniform. The European legislation regulates the acquisition and recognition of professional qualifications by the Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications (OJ L 255, 30.9.2005) and Directive 2013/55/EU of the European Parliament and of the Council of 20 November 2013 amending Directive 2005/36/EC on the recognition of professional qualifications and Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System ('the IMI Regulation') (OJ L 354, 28.12.2013, p. 132–170). The legislative approaches at the national level are different in different sectors. As a justification for national restrictions on freedom to provide services, the Member States usually recall the reasons of the public interest: protection of tourists, guaranteeing public security, fight against tax evasion, maintaining a level playing field in the market, protection of public health and food safety and elimination of the problem regarding insufficient capacity for housing citizens at affordable prices and so on. In some Member States, except the ones where there are specific sectorial regulations, there were targeted regulatory interventions caused by the participants' entry of in the collaboration economy on the market (EC Agenda, pp. 3).

Under EU Law, in particular Article 49 and 56 of the Treaty on the Functioning of the European Union (OJ C 326/47, 26.10.2012, Further: TFEU) and by the provisions of Articles 9 and 16 of the Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services at the internal market (OJ L 376, 27.12.2006. Further: "Services Directive") the freedom to provide services and freedom of establishment for service providers in other Member States are guaranteed. Pursuant to the aforementioned provisions and as set forth by ECJ, service providers are not to be subject to market access or other requirements, such as authorization schemes and licensing requirements, unless they are non-discriminatory, necessary to attain clearly identified public interest objective and proportionate to achieving this interest. The European Commission Agenda points out that the Services Directive requires the national authorities to review the existing national legislation to ensure that market access requirements continue to be justified by a legitimate objective (pp. 4). These requirements must be proportionate and necessary. The justification and proportionality of the national legislation in the context of the collaborative economy cooperation will have to take into account the specifics of the business model of collaborative economy and tools that can be introduced in order to resolve issues related to the public policy concerns, for example in terms of access, quality or safety.

In general, the situation when the service provider is a professional needs deep analysis of the legal framework of professional services provisions and application of the Directive 2005/36/EC on the recognition of professional qualifications in order to establish the legal framework.

3.2. Collaborative Economy when services are provided by traders

The definition of trader differs from country to country and is governed by national law. The contracts signed by traders on one hand and persons who are not traders on the other hand are considered to be in the primary sense the consumer contracts. This definition of consumer contracts is accepted at the European Union level, and in any case the provisions relating to the protection of consumers as weaker contracting party are applied to such contracts. Within the EU law, consumer is considered as a weaker part. Under Article 2(a) of the Directive 2005/29/EC concerning unfair business-to-consumer commercial practices (Further: Unfair Commercial Practices Directive), the common definition of the trader is that „a trader is a person acting for purpose relating to his trade, business, craft or profession and „a consumer

is a person acting outside his trade, business, raft or profession“. Regulation of such legal relations will certainly be easier knowing that one party is by definition a trader and that must comply with the requirements laid down at national level and act in accordance with them. In terms of European law, traders can provide services in a way their right is based on freedom to provide services or freedom of establishment. In any case, it comes to implementing the provisions of the TFEU which regulate these freedoms and provisions of the Services Directive.

In the context of consumer protection, the provision of services by traders in the collaborative economy cooperation is in fact the easiest task to regulate considering that in consumer contracts a precondition for the application of consumer protection rules is that one party is a trader. What is not so easy to define regarding the application of consumer protection rules is the question of collaborative economy when it is fulfilled in the „peer to peer“ relationship when neither of the participants is a trader and still there is a situation that one „peer“ is providing a service and another „peer“ is receiving it.

3.3. Collaborative economy when services are mutually provided by individuals (peer-to-peer)

The provision of services in the context of collaborative economy by the persons who are neither traders nor professionals is one of the fundamental features of this business. It is a service that is provided by the persons who offer their goods or services on an occasional basis "peer-to-peer". In the EC Agenda it is pointed out that in the context of collaborative economy in assessing whether a request for access to the market is necessary, justified and proportionate, it is required to determine whether it is offered by the professional services provider or is it provided by a private person on an occasional basis.

The EU legislation does not expressly state in which moment the individual (peer) becomes a professional service provider in the collaborative economy. The provisions of the national legislation should be analyzed in the context that there is possibility for individual to provide services without being registered as a trader (Parać, 2001; Momčinović, 2009).

According to EC Agenda, Member States apply different criteria to determine the distinction between professional services and peer-to-peer. Some Member States define the services as services provided for a compensation, as opposed to the “peer-to-peer” services, which aim to reimburse the providers cost. Part of the Member States introduced a threshold for determining these differences. The thresholds are often determined depending on the needs of specific sectors, which take into account the level of resulting income or regularity of service. Below these thresholds, the providers are usually subject to less restrictive requirements.

4. COLLABORATIVE PLATFORMS

Collaborative Economy as a phenomenon was a result of development of digital media, in particular Internet platforms. Internet platforms actually represent service for mediation between the providers and recipients of services in collaborative economy. As the fundamental question, the EC Agenda points out whether and to what extent a platform for cooperation and service providers in accordance with existing EU law is the subject to the requirements for market access. In this respect, it is emphasized that this may relate to the powers operating obligations obtaining concessions or requirements regarding the minimum standards (e.g., room size or type of car, insurance obligations or leaving a deposit etc.). These requirements should not be discriminatory, must be justified and proportionate, taking into account the specifics of the business model and the subject of innovative services and should not give preference to one business model over others.

In order to answer the question whether and to what extent a collaborative platform is subject to the requirements for market access, the answer depends on the nature of their activities.

Pursuant to Art 2 (a) of 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, 17.07.2000) and Art. 1, paragraph 1, (b) of Directive (EU) 2015/1535 of the European Parliament and of the Council of 9 September 2015 laying down a procedure for the provision of information in the field of technical regulations and of rules on Information Society services (OJ L 241, 17.9.2015), as long as the platform for collaborative economy provides a service that is usually done for remuneration, at a distance, by electronic means and at individual request made by recipient of services, they provide information society services. Therefore, they cannot be subject to the application for obtaining prior authorization or any equivalent application specifically and exclusively aimed at those services (see Article 4 of the E-commerce directive). Furthermore, Member States may prescribe regulatory requirements for the collaborative platforms when they provide cross-border services only under limited conditions and under a special procedure (see Articles 2 and 3 of the E-commerce directive).

However, there may be cases in which it can be considered that collaborative platform beside the information society services, offers also other services by mediating between providers of services and their users. In particular, in certain circumstances, the platform can also be a provider of background services. In this case, the collaborative platform could be subject to the relevant sectorial regulations, including requirements for authorization of operations and concession.

If the collaboration platform provides background services as well, it will be determined on an individual basis. In that case, it is of outmost importance that the control level and influence are realized by this platform to service providers. The EC Communication establishes the criteria on the basis of which the provision of background services can be determined:

1. Price: does the collaborative platform set the final price to be paid by the user as the recipient of underlying service. Where the collaborative platform is only recommending a price or where the underlying services provider is otherwise free to adapt the price set by a collaborative platform, this indicates that this criterion cannot be met.
2. Other key contractual terms: does the collaborative platform set terms and conditions, other than price, which determine the contractual relationship between the underlying services provider and the user (such as, for example, setting mandatory instructions for the provision of underlying service, including any obligation to provide the service).
3. Ownership of key assets: does the collaborative platform own the key assets used to provide the underlying service.

As defined by the EC Agenda, when these three criteria are all met, there are strong indications that the collaborative platform exercises significant influence or control over the provider of underlying service, which may in turn indicate that it should be also considered as providing the underlying service (in addition to an information society service). Depending on the case at hand, other criteria may also play a role; for instance, if the collaborative platform incurs the costs and assumes all the risks related to the provision of underlying service or if there is employment relationship between the collaborative platform and the person providing the underlying service in question (see section 2.4).

5. CONCLUSION

The regulatory approaches regarding the collaborative economy differ in EU Member States. The collaborative economy operates across many sectors and competes with both traditional and collaborative economy providers. Premature intervention in this field could result in reduced competition, in barriers to entry for new providers and negative impact on consumer

welfare (Zuluaga, 2016). It is important to change the regulation along with the economy, rather than trying to adapt innovative business models to existing rules. Otherwise the EU economy will not be able to capture the large potential benefits offered by collaborative economy business models (Zuluaga, 2016). A possible solution is the self-regulation that can be made by the platform or by the collaborative economy participants (Cohen, Sundararajan, 2015).

In any case, if the European Commission will proceed with a common set of rules, the existing legislation on certain topics should be taken into concern. As stated in the EC Agenda, the EU legislation on consumer protection and marketing of the product has traditionally been designed to solve the issues associated with transactions in which there is a weaker party that needs to be protected (typically consumer). However, in the context of the collaborative economy, due to the multi-faceted cooperation relations which may include transactions between the traders, traders and consumer and consumer with consumer, the boundaries between the consumers and traders are lost. In these relationships it is not always clear who is the weaker party in need of protection (Koopman, Mitchell, Thierer, 2015; Beltra, 2016).

By applying the "traditional" criteria of division between the consumer and trader in the collaborative economy the respective rights and obligations of the parties should be based on the existing EU legislation on consumer protection and trade.

The EU consumer protection law applies to all collaborative platforms that can be categorized as "trader" and are engaged in "commercial practices" in relation to consumers. Providers of background services can be also traders if they act for the purposes relating to their business activity. On the contrary, EU law on consumer protection and marketing of the product does not apply to transactions between consumers and the consumer. Therefore, if in the context of collaborative economy neither a service provider nor a user can be categorized as a trader, transactions between them will be outside the scope of this legislation.

This raises the key question of under what conditions in the context peer-to-peer service provision the background services provider can be considered as a trader. In order to give the answer on the question who is the consumer and who is a trader in collaborative economy, it is recommended to take into account the frequency of provision of services where it is less likely that providers who offer their services only occasionally will be considered as traders. Probably one of the easiest objective criteria will be the level of turnover: the service provider that achieved the higher turnover (either on one or more collaboration platforms) is more likely to be considered as a trader. In this regard, it is important to assess whether the level of turnover results from the same activity (e.g., sharing transportation) or different types of activities (sharing transport, gardening, etc.). In another case, a high turnover does not necessarily mean that the service provider meets the requirements to be considered as a trader because it is not necessarily achieved in conjunction with its other (main) job. Future consumer rights will be determined after answering the question of who is a consumer in the collaborative economy.

LITERATURE:

1. Barnard, C. (2007). *The Substantive Law of the EU: The Four Freedoms*. Oxford: Oxford University Press.
2. Bauwens, M, Niaros, V. (2017). *The emergence of peer production: challenges and opportunities for labour and unions*. ETUI Policy Brief. No. 3/1017.
3. Beltra, G. (2016). *The consumer-policy nuts and bolts of the sharing economy.* BEUC Consumer Corner. The BEUC Blog.

4. Berg, J, De Stefano, V. (2016). *Want to improve crowdwork? Regulate it.* Global Labour Column. University of Johanesbourg. Retrived 16.02.2017 at http://column.global-labour-university.org/.
5. Berg, J. (2016). *Income security in the on-demand economy: findings and policy lessons from a survey of crowdworkers*. ILO Conditions of Work and Employment Series, Working Paper No. 74, Geneva, ILO.
6. Bardhi, F, Eckhardt, G M, (2012) *Access-Based Consumption: The case of car sharing*, Journal for conumer research, Vol.39.
7. Chen, Y. (2009). *Possesion and Access: Consumer Desires and Value Perceptions Regarding Contemporary Art Collection and Exhibit Visits*, Journal of Consumer Research, Vol.35.
8. Codagnone, C, Biagi, F, Abadie, F. (2016). *The Passions and the Interests: Unpacking the 'Sharing Economy'*. Seville: Institute for Prospective Technological Studies, JRC Science for Policy Report EUR 27914 EN.
9. Cohen, M, Sundararajan, A. (2015). *Self-Regulation and Innovation in the Peer-to-Peer Sharing Economy*. 82 U Chi L Rev Dialogue 116. Retrived 16/02/2017 at https://lawreview.uchicago.edu/sites/lawreview.uchicago.edu/files/uploads/Dialogue/Sundararajan_Cohen_Dialogue.pdf.
10. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Upgrading the Single Market: more opportunities for people and business, Brussels, 10.28.2015. COM (2015) 550 final, available at https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-550-EN-F1-1.PDF
11. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Strategy for Digital Single Market for Europe, Brussels, 6.5.2015. COM (2015) 192 final, available at: https://ec.europa.eu/digital-single-market/news/digital-single-market-strategy-europe-com2015-192-final
12. Craig, P, De Burca, G. (2008). *EU Law, text, cases and materials, 4th edition*. Oxford. Oxford University Press.
13. De Stefano, V. (2016). *The rise of the just-in-time workforce: on-demand work, crowdwork and labour protection in the "gig-economy*", ILO Conditions of Work and Employment Series, Working Paper No. 71, Geneva, ILO.
14. European Comission (2016). *Synopsis Report On The Public Consultation On The Regulatory Environment For Platforms, Online Intermediaries And The Collaborative Economy*. Retrived on 16/02/2017 at https://ec.europa.eu/digital-single-market/en/news/full-report-results-public-consultation-regulatory-environment-platforms-online-intermediaries.
15. European Commission (2016). *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions A European agenda for the collaborative economy*, COM(2016) 356 final, Brussels, 2.6.2016.
16. European Parliament (2016). *Sharing economy: They come in like a wrecking ball*, Brussels.
17. Ertz, M, Lecompte, A, Durif, F. (2016) *Neutralization in collaborative cconsumption: An exploatation of justifications relating to a controversial service*, Proceedings of the 27th Conference of the Society for the Advancement of Socio-Economics, 24-27 June 2016, University of California at Berkeley, San Francisco, USA: Humanistic Management Network, Research Paper Series No. 31/16.

18. Horak, H, Bodiroga-Vukobrat, N, Dumančić, K. (2015). *Sloboda pružanja usluga na unutarnjem tržištu Europske unije*. Zagreb: Školska knjiga.
19. Horak, H, Bodiroga-Vukobrat, N, Dumančić, K. (2014). *Professional qualification and diploma recognition in EU law*. Zagreb: InterEuLawEast Journal for the International and European Law, Econmics and Market Integrations, Vol.I, Issue I.
20. Horak, H, Bodiroga-Vukobrat, N. (2004). *Sloboda pružanja usluga u pravu EZ s posebnim osvrtom na turističke vodiče.* Zagreb: Acta Turistica. Ekonomski fakultet. Vol 16. Br.2.
21. Horak, H, Dumančić, K. (2011). *Problemi implementacije Direktive o uslugama u pravo Rh – odustajanje od socijalnog modela na nacionalnom nivou.* Rijeka: Zbornik Pravnog fakulteta Sveučilišta u Rijeci. Vol.32. Br.2.
22. Koopman, C, Mitchell, M, Thierer, A (2015) *The Sharing Economy and Consumer Protection Regulation: The Case for the policy change*, 8. J.Bus. Entrepreneurship & L.529
23. Lehrer, E, Moylan, A. (2014) Embracing the Peer-Production Economy, NAT˙L AFFAIRS 51,56.
24. Leong, N. (2014). *The sharing economy has a race Problem*, Salon, 2 November.
25. Marvit, M.Z. (2014). *How Crowdworkers Became the Ghosts in the Digital Machine*, The Nation, 5 February. No. 06/2015.
26. Perret, B. (2014). *De la propriété à l˙usage*, Esprit, 7 julliet.
27. Ranchordás, S. (2015). *Does Sharing Mean Caring? Regulating Innovation in the Sharing Economy*, Tilburg Law School Legal Studies Research Paper Series, No 06/2015, Tilburg University
28. Regulation: The Case for Policy Change. 8 J. Bus. Entrepreneurship & L. 529 (2015). Retrieved 16/02/2017 at: http://digitalcommons.pepperdine.edu/jbel/vol8/iss2/4.
29. Silberman, S., Irani, L. (2016). *Operating an employer reputation system: lessons from Turkopticon*, 2008–2015, Comparative Labor Law & Policy Journal, 37 (3) Spring.
30. Ranchordás, S. (2015). *Does Sharing Mean Caring? Regulating Innovation in the Sharing Economy*, Tilburg Law School Legal Studies Research Paper Series
31. Zuluaga, D. (2016). *Regulatory approaches to the sharing economy*, Institute of Economic Affairs. Retrived 16/02/2017 at https://iea.org.uk/wp-content/uploads/2016/07/Regulating%20the%20sharing%20economy%20Briefing%202016.pdf

INTRODUCTION OF NEW BUSINESS STRATEGIES BASED ON SUSTAINABLE DEVELOPMENT IN THE FAMILY HOTEL INDUSTRY SEGMENT IN CROATIA

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
A small family hotel in Croatia is a segment of the national tourist offer with great potential which is currently not adequately used. New development strategies that will not only be based on realistic potential but will also successfully implement the concept of sustainable development are needed. Considering the fact that small family hotels, compared to larger hotels, in both the national and global market, are the most recognizable by a personalized approach, the proposed strategy is the implementation of the concept of heritage interpretation, a relatively new trend in European and world tourism. It is not only an innovative concept that will raise the quality of the offer, but it is also a way of solving one of the biggest family hotel problems in Croatia, which is a remarkable seasonality of business.
Keywords: *interpretation of heritage, small family hotels, family hotel, sustainable development, tourism*

1. INTRODUCTION

Family hotels should be differentiated on the market as hotels that offer a personalized approach which is generally not possible in large hotels. But apart from the lack of content to develop such initiatives, the problem of small family hotel in Croatia is seasonality of business. Since the obstacles to the realization of operations in the period before and after the season or in the spring and autumn months, as the climatic conditions in most of our country is concerned, do not exist, it is obvious that the key problem is the lack of content that would attract guests in that period. So one can conclude that one of the biggest problems of small family hotels in Croatia is the seasonality of the offer, with the lack of additional content, ie the kind of content that would attract guests even out of the standard tourist season.

Based on this, and in line with the fact that small family hotels differ largely by the personalized offer, the new business strategy proposal is the introduction of so-called interpretation of heritage in the tourist offer.
It is a relatively new trend in our country, which already shows good results in practice, and is based on the exploitation of the potential of the destination in a different way, and not in the standard direction - sea, sun and monuments, but through the interpretation of lesser known elements of cultural and natural heritage with larger degree of involvement of the destination, according to the principles of sustainable development.

2. FAMILY HOTEL INDUSTRY IN CROATIAN TOURIST OFFER

2.1. General features

Family Hotel Services, as a vital and important segment of tourist offer in Croatia, is characterized by a high level of attractiveness in different market niches and presents a space for designing and implementing initiatives and strategies for enriching the offer and achieving differentiation on the market. The National Program for the Development of a Small Family Hotel in the Institute of Tourism of the Republic of Croatia emphasizes that it is an extremely important segment of the national tourist offer, but also a segment which, despite the potential, is not developed sufficiently connected to the other accommodation and catering offer in Croatia. Generally, small family businesses in a broader sense, not just family hotels, are the most common form of tourist offer in Croatia, and their importance must be emphasized not only in the context of the number but also in the context of contributing to the process of creating and building the identity of a destination on the global tourist map. Family hotels, defined by size, in order to be treated as such a type of establishment, must have a minimum of five accommodation units, along with the prescribed facilities. There are four distinct categories now, and it is possible to request a special quality tag within this frame. As far as the institutional framework is concerned, there are no special laws currently in the Republic of Croatia regulating family hotel management as a special accommodation and catering category.

As for the quantitative indicators related to the segment of small family hotels in Croatia, there is no statistics that tracks only that type of accommodation and catering facilities. According to the Institute for Tourism, there are about 340 small family hotels in the area of our country, with a total of between 7 and 8 thousand accommodation units, or just over 15.5 thousand beds (Institute for Tourism, 2013). According to the same source, most of the small family hotels in Croatia are in the category of three star hotels, 57 percent, and the least are in the category of five star objects, only two percent (Table 1).

CATEGORY OF THE OBJECT	SHARE
2*	12%
3*	57%
4*	22%
5*	2%
APARTHOTELS	7%

Table 1 The facilities by category (Institute of Tourism, 2013)

According to the share of capacities per individual counties, 71 percent of small family hotels are located in coastal areas; most in region of Split, 19 percent, and the least in the region of Lika-Senj - four percent (Table 2).

REGION	SHARE
Split - Dalmacija	19%
Kvarner i gorje	13%
Zadarska regija	7%
Istra	14%
Šibenska regija	6%
Dubrovnik	8%
Lika - Senj	4%

Table 2. Share of facilities by counties (Institute for Tourism, 2013)

2.2. The ratio of supply and demand

Current world trends show that tourists are increasingly seeking privacy and personalized access to service delivery, which is in line with new trends in almost all business sectors, especially service-based ones. The emphasis is on the more complete experience of the destination associated with the accommodation unit - the function of the accommodation unit as a sleeping facility is no longer sufficient, it is necessary to offer additional facilities in an attractive but unique way to complete the tourist offer as much as possible. This, on the one hand, presents a big challenge for family hotels but at the same time offers a wide range of options for designing and improving the offer, primarily through connecting with the destination, and it is unnecessary to mention that each destination offers a number of unique, recognizable natural, cultural and other resources, which helps building a unique image.
The advantage of small family hotels, compared to larger accommodation and catering establishments, is the fact that they can offer better attention to each individual guest, creating an impression of the family atmosphere and home, providing the maximum individualized offer by, for example, making traditional dishes, and getting the guests acquainted with local customs. However, it is necessary to develop (new) strategies for small family hotels in Croatia in order to attract more attention on the global market, and this primarily means that we need to find ways in which we could make the most of all these resources In other words, the current supply and demand is relatively favorable, but the offer must be headed in the direction of stronger branding, thinking, focusing on a specific target group and, of course, raising the level of quality.

2.3. SWOT analysis and key competitive advantages

The attractiveness of the location, the overall good image of Croatia on the global tourist scene (Croats as hospitable hosts etc.) are certainly some of the greatest strengths of small family hotel segments but there is still low profitability, high seasonality, and insufficiently developed quality management system which are weaknesses that hinder the development of this part of the domestic tourist offer. As for the relationship between the opportunity and the threat, we have stable demand, implementation of modern forms of marketing and promotion, initiatives in the direction of supply thematization and opportunities for using EU funds targeted at regional development, but on the other hand the threats to the development of family hotel Croatia are characterized by insufficiently developed state-aiding system and generally unfavorable economic climate in the country (corruption, lack of skilled managerial staff) and lack of innovativeness.

The SWOT analysis is presented in Table 3.

Table following on the next page

STRENGTHS	WEAKNESSES
Destination Attractiveness (Micro location) Attractiveness of Destination Macro-environment Affordable image (hospitality of the host) Association of Bidders The growing quality Good value for the price of the service	Low profitability Undeveloped quality monitoring system Indebtedness Low adequate staff Inadequate promotion Lack of adequate branding unrecognizable brand Insufficient motivation Seasonality of business Lack of innovativeness
OPPORTUNITIES	**THREATS**
A somewhat defined institutional framework Growing demand for this form of supply Availability of EU funds Availability of modern forms of promotion	Negative economic climate in the country Inadequate incentive system Non-transparent business environment The level of fiscal and parafiscal benefits The fall of small business entrepreneurship Undeveloped destination management system

Table 3. SWOT analysis of small family hotel segment

Competitiveness rating is based on the assessment of the facility itself and the assessment of the destination (micro location).
A key competitive advantage in the supply of small family hotels should be focused on those resources, and the benefits of destination, which are the best and largely meet the needs of specific target groups, which implies a high level of understanding of the profile of visitors – which would be an adequate adjustment of supply and value chain.

2.4. Objectives and possible directions of development

The national program of small family hotel development in the Republic of Croatia sets five key goals for the development of this segment of the national tourist offer, namely: a) international recognizability (building a globally recognizable brand), b) "thematicity", c) orientation towards consumer segments, d) qualitative uniformity; e) focus on environmental awareness and environmentally friendly way of doing business.
Although these goals are not defined or concretized sufficiently, they present a solid basis for elaborating specific goals.
However, in order to move to this process, adequate preconditions have to be achieved, primarily related to legal deregulation, education, and training of managers and other staff, clustering and, the creation of a more favorable investment climate in general.
The national program for developing small family hospitality states that small family hotels in Croatia should be attracting attention based on the warmth and privacy, quality and excellence, authenticity and tradition, the wealth of experience and hospitality.

Although none of the above attributes could be called redundant, they lack specificity - everything mentioned can be mapped as a desirable direction of development and identity building and also to other segments of tourist offer in Croatia and in general.
It is therefore necessary to understand these attributes as a basis and focus on some of them, to select the ones that best fit into the context of current trends and which will successfully link the supply and demand and which, most importantly, are more realistic at this point. This is why it is necessary to think in the direction of new strategies that will consolidate the potentials, the most important segments of demand and innovation, which, as in other sectors of the economy and tourism, is always one of the key factors in creating and improving business strategies and services.

3. SUSTAINABLE DEVELOPMENT AS A BASIS OF SUSTAINABILITY

3.1. The importance and challenges of implementation measures for sustainable development in the Croatian tourism

Sustainable development implies economic and social growth based on compliance with ecosystems within the framework, which means that it is sustainable in the long run (Črnjar, 2002). It is a very current term that is, in theory, mentioned in almost all kinds of development strategies: in science, in the media, but it is not realized very often in practice. Sustainable development is particularly concerned with tourism, given the wide range of activities it encompasses and includes, since the tourism, as one of the most important economic branches in Croatia, largely uses natural resources, often in ways that are not in line with the guidelines for sustainable development.
In this context, sustainable tourism should be based on a concept that will meet the needs of present and future generations in a way that will maximize the existing resources without causing problems to future generations. However, tourism does not only rely on natural resources but also on other resources, but depends entirely on natural resources. Therefore the implementation of the guidelines for sustainable development is imperative for the sustainability of tourism as an important economic branch.
Development, in order to be sustainable, above all must be based on quality and responsible planning, with a focus on the preservation of local natural, cultural, traditional, social and other values (Sunara et al., 2013).
Sustainable tourism conditions resource management in order to meet current economic and social needs while preserving the cultural, ecological and biological diversity of destinations; in this sense, sustainable tourism refers to ecotourism, agro tourism and rural tourism (Zlatar, 2010). However, sustainable tourism based on the guidelines of sustainable development, should be implemented in the development strategies of all other types of tourism. There is no argument strong enough for any different treatment, and there are no obstacles to get into some other form of tourism - for example, in health tourism - implementing the items of sustainable development. Such tourism, based on the preservation of natural and other resources, is not just the only acceptable form of tourism in terms of adequate environmental care and other values we have, but also, if conducted properly and timely, presents one of the most powerful competitive advantages of our country. Croatia, as part of the Mediterranean, is an attractive tourist destination mostly because of its nature and its rich cultural and historical heritage and the attractiveness and popularity of the destination. However, that could lead to the negative effects of tourism - which is evident in the examples of many developed Mediterranean tourist countries such as Spain, France, Italy, Greece and Turkey. Tourism in these countries has damaged the landscape, often irreversibly, at various levels, primarily ecological but also in aesthetical, economical and other ways (Klarić, 2002). It is the fact that tourism is also largely (if not entirely, at least when Croatian is concerned)

dependent on intact ecosystems and, on the other hand, there is a lot of pressure on those ecosystems, which often has negative consequences, as we have seen in these examples, the biggest challenge is to create development strategies that will be based on the concept of sustainable development.

3.2. Proposal for new business strategies based on sustainability with the aim of improving the family hotel business in Croatia

The business strategy of development and promotion of domestic hotel industry in Croatia that would be based on the guidelines of sustainable development must first answer key questions such as: a) protecting the preserved environment (space) and value (inheritance, etc.), b) which are the key competitive advantages of specific area, location, as a tourist destination, c) which are the restrictions of planned (desired) direction of development, d) what is the role of institutions in this development (Government, local self-government), e) in which extent will the development be based on existing identity and image, ie on existing cultural, historical, economic and to what extent it can create new values or new identities; and f) how to create a sustainable development strategy (Vidučić, 2007).

These issues also present the development guidelines, and they are different and unique for each individual destination. To put it in a more realistic context, we will consider these questions as an example of a selected Croatian tourist destination, in this case the island of Korcula. It is a destination that is well known on the travel map of the world - in 2014, the renowned German magazine HORZU selected the island of Korcula as the most beautiful island in the world, and after that numerous foreign media continued to praise this Croatian island; The international travel portal of Travel and Leisure 2015 called Korcula "the new Santorini", etc.

The island of Korcula has been recognized for its extremely attractive, and preserved nature, its rich cultural and historical heritage, as well as preserved "spirit of the Mediterranean", excellent climatic conditions, excellent, world-famous wines and traditional dishes.

Current and previous great positioning on the world tourist map is largely due to natural beauties, and it is an evidence that Korčula could achieve even better results, but the tourist offer of the island is still based on standard forms of supply – the sun and sea, a few cultural events, the use of the name of Marco Polo, who was born on Korcula allegedly and the gastronomy, which, although known and acknowledged, does not particularly dissipate from other Dalmatian islands, or is not sufficiently differentiated and positioned the market, despite the potential. It is clear, therefore, that the tourist offer of the island of Korcula is currently not special in any way and as such it does not stand out in the market and owes its popularity solely to natural resources, not to the intended and adapted or innovative tourist facilities. One of the reasons for this situation lies in the fact that in the tourist offer of the island of Korcula there is no initiative and innovation in the creation of unique tourist facilities that would fit into the existing resources and exploit the other potentials, which might differentiate it from increasingly demanding global tourism market.

The strategy that would incorporate all of the above, and at the same time fit into the concept of sustainable development, would be the introduction of additional features which are based on the interpretation of heritage. It is also a strategy that would solve not only the problem of the lack of additional, new content, but also the problem of seasonality, which also affects family hotels on the island of Korcula.

The interpretation of heritage is a relatively new trend in tourism, at least in our area, which already shows very good results. An example of good practice is the project of Secret Zagreb, which organizes unique tourist tours in Zagreb, which function outside the classical frames and offers visitors the interpretation of heritage, ie the history and ethnology of the destination, revealing the hidden and neglected history of the city, while interpreting the

heritage in a different way by exploring and reviving forgotten legends, myths, and creating stories that bring a dose of mysticism and fantasy. The project proved to be extremely attractive to Zagreb's visitors and has achieved the essential goal: it has extended the tourist season and attracted visitors who arrived in the off-season to participate in the events offered by this company or to experience Zagreb in a different way.

The interpretation of heritage as one of the ways in which family hotels can accomplish a successful business out of the season is based on the transfer of information regarding some form of heritage or any kind of inheritance (both material or immaterial, cultural or natural), but the focus is on the user, ie the one to whom the interpretation is addressed (Croatian Association for the Interpretation of Heritage, 2016).

The aim is to get the guest, client, or users interested in the interpretation of the heritage as well as to entertain, educate, and ultimately encourage them to visit the destination outside of the summer months or the standard tourist season. The interpretation of heritage in a new and different way connects the guest and the destination, and is characterized by creativity, authenticity and innovation. On the other hand, it requires professional access and involvement of experts, but in the long run there is an enormous potential, especially in the market saturated with a classic tourist offer, and especially in the segment of small and family hotels lacking the offer and additional facilities and who must find a way for to attract guests the whole year, and not just during the summer months.

In the example of the island of Korcula in particular, there are all the prerequisites for the interpretation of the heritage to be incorporated into the existing tourist offer - the island has a lot of legends, full of mystical beings (fairy, witch, vampire, siren) that mix elements of Slavic mythology with the Mediterranean, with indigenous, island stories that combine actual historical events (maritime battles, pirate attacks) and fiction (fairy tales, supernatural events and beings, etc.). What is particularly interesting is the fact that folk traditions are mainly related to certain localities (forts, crags, coves, caves, beaches, rocks) that give the story an additional dimension, and vice versa, which creates a complete, unique platform for the development of tourist facilities.

At the same time, this way of creating a tourist offer could fully fit into the concept of sustainable development, which is concerned with the preservation and protection of nature - which certainly must be an imperative. Many of these sites, which are tied with folk tales and fairy tales, have been neglected, even to the extent that some sites have become landfills spontaneously, especially when it comes to smaller bays on the south side of the island. Revitalizing these sites with the use of national cultural heritage would also mean increased care for these sites as well as investing some of the profits generated by using these sites in order to further protect and preserve their nature.

Tourism can greatly assist in the protection of natural resources and beauty, but there is a need for coordination between protection of nature and tourism, and it is most needed in the educational area where tourism helps to protect nature, "bringing together masses of the most diverse social composition and diverse cultural levels. In places of particular natural beauty, tourism contributes to the increase of general sympathies towards nature and develops an understanding of the nature protection problem "(Alfier, 2010, p. 11).

The forests of the island of Korcula, for the which the island is known (the old Greek name of the island is Korkyra Melaina or Latin, Korkyra Nigra, because of the rich conifers), along the forests near Poreč and Rovinj, forests on Elafiti, Čikata near Mali Lošinj etc. is one of the most valuable and most vulnerable forest complexes in our country that have been seriously threatened by mass tourism and the lack of adequate protection strategies, as well as the lack of promotion of the importance of protecting and preserving these areas (Alfier, 2010, pg. 11). The interpretation of natural and cultural heritage as a part of tourist offer is an adequate developmental strategy because the trend of returning to nature and the natural and cultural

values, as well as growing demand for differentiated natural spaces in modern tourism (Alfier, 2010.). Furthermore, the interpretation of heritage in this case is also a powerful differentiation generator on a saturated market - each destination has a unique and original heritage and therefore this offer is virtually unique, which is a strong competitive advantage which is created, among other things, by the generic strategy of differentiation or by trying to make the product, service or offer unique, at least in some of its dimensions if not completely (Porter, 2008). Furthermore, the interpretation of heritage as a strategy implements the focusing strategy as a way of achieving and increasing the competitive advantage "because it is based on the choice of a narrow range of industry competitiveness" (Porter, 2008, p. 25). All these arguments for the introduction of the interpretation of heritage as a new strategy for sustainable development in tourism have recently become more frequent among experts, who are increasingly recognizing the advantages of such an approach - but the unique cultural, historical and natural wealth of a particular destination as a platform for new developmental strategy and differentiation on the market requires a research-analytical approach and redefinition of the ways of deployment of destination management, depending on the destination itself and the new trends in tourism. One of the best examples of introducing such a unique strategy in Croatia is perhaps Brijuni, or Brijuni National Park. The reason for this is that the interpretation of heritage is comprehensive, unique and maximized, and completely based on sustainable development (Gržinić, Vodeb, 2015).

Current trends in tourism show that it is a branch of industry that is constantly on the rise - the WTO (World Tourist Organization) forecasts annual growth rate in cross-border tourism between 4.5 and 5.5 percent; and there is a growing emphasis on individual visits, exploration of lesser known destinations, and education through visits to the destination (Moutinho, L. (2005). All of this offers a strategy based on the interpretation of heritage.

If we make the interpretation of heritage in the cultural tourism context, where this segment of research shows growth - the data of the WTO indicate the rise in the popularity of cultural tourism on a global scale, claiming that by 2020 this segment predicts an average annual growth rate of 15 percent (Tourism 2020 Vision Europe, 2000; Jelinčić, 2008).

Since the tourists are increasingly seeking a more active vacation and new experience, mass tourism which has marked a relatively short development and a lightning strike, has been decreasing and is being abandoned in the last decades, opportunities for other levels and ways of creating tourist offers are opening up. It should also be noted that mass tourism was not in line with the concept of sustainable development, so leaving such forms of tourism is a positive trend. Furthermore, new trends in tourism show that there is growing differentiation and pluralization of demand. New, specialized markets are emerging, the aspiration for active recreation and the more detailed introduction of the destination increases (Moutinho, L., 2005). Those are the challenges to which a tourist offer based on the interpretation of the heritage can fully respond to. Such a strategy, as mentioned above, can also significantly influence the extension of the tourist season because it is not necessarily related to the summer months and, on the island of Korcula, for example, but also in most tourist destinations in Croatia, we can see that favorable climatic conditions enable successful tourism results to be achieved in the spring and fall months. But when it comes to interpretation of heritage, the time of year does not play a key role when it comes to tourism offer based on "sun and sea". However, in order to solve the problem of seasonality, it is necessary to create a brand from the destination, which for the initial phase means profiling and then the need for strong marketing occurs. It should also be kept in mind that the new era of tourism has led to changes in the marketing environment, fragmentation of the demand market in particular as well as the increase in the number of educated tourists, the dissatisfaction of tourists with contaminated destinations ... (Križman Pavlović, 2008, 83). Marketing, therefore, must be based on building brand destinations, and this in the case of

implementing the strategy interpretation of heritage, can be achieved by focusing on authenticity. Clearly, authenticity is one of the main features of every brand, but in this case, the authenticity of the destination should be seen as a specific type of authenticity, the "native", which has always existed practically and independently of market trends, competition and demand which is the case with brands in general. That is why brending destinations on the basis of its authenticity are special area of marketing which, as such, requires a different approach. The approach depends on the management and how the destination branding is defined at a given time and for a given location. That is still a big challenge, as many world experts doubt that places can be branded or that destinations can become brands in an the marketing sense, so critics of such an approach note that it is actually a reputable destination or "competitive identity "and not, in fact, matter of branding (Morgan, Pritchard, Pride, 2011). However, the mentioned example of the National Park Brijuni greatly contradicts this view - because Brijuni is indeed a Croatian brand - which means that it is possible to talk about branding the destination, but it also means that it is a serious challenge. The interpretation of heritage is certainly an adequate strategy when it comes to branding the destination, even if we look at branding as the aforementioned reputation of a destination or a competitive identity. It is important to be guided by the current world trends not only in tourism but also in branding. Among other things, this way of improving the tourist offer - through the interpretation of heritage - is in line with recent marketing trends, in particular with the principles of the so-called Emotional branding (Gobé, 2001) that relies on the "story", the "feeling", the deepening of the emotional connection between the product or the service, and the client, in this case the visitor, the guest, the tourists, and vice versa, not only with the market, but with the general public, too. Branding is "a complex process of creating identities, features, distinctions and brand ideas, its relevance to consumers, and the management of signals that convey the idea to consumers in order to feel, experience and accept" (Pavlek, 2008), which can also be applied when it comes to a tourist destination and when it comes to a small family hotel. Gobe mentions linking visitors to the destination through the hotel as a medium and Gobé defines emotional branding as "dynamic cocktail of anthropology, imagination, sensory experience and visionary approach to change" (Gobé, 2001). Based on this, he redefines the construction of the brand according to the current social and market trends, through the so-called. The Ten Commandments of Emotional Branding emphasizing that consumers need to be "included", and to satisfy their needs not only at the functional level, but also to create an experience, awaken a certain emotion in the consumer, achieve a preference, a personality of the inside. The interpretation of heritage, as part of the tourist offer, is in line with these principles and with the personalized approach of what small family hotels have, or what they should have. For the success of this strategy is, except the resources or heritage inherent to every destination, training of a skilled personal is crucial. Formal educational programs dealing with heritage interpretation in Croatia do not yet exist, but there are initiatives, organizations and individuals developing programs in line with recent global trends in this area. One of these organizations is the Croatian Interpreting Association, founded in 2016, with headquarters in Zagreb, "with the aim of promoting excellence and efficiency in the interpretation of Croatian natural and cultural heritage, as well as raising the awareness of its importance for the development of local communities". It is a part of the European umbrella association for the interpretation of heritage - Interpret Europe. The interpretation of heritage as a way to enrich the tourist offer in the context of small family hotels is an innovative way that has been proven to be a successful strategy in the world, and Croatia, with its rich cultural and historical heritage, has the necessary preconditions for implementing this type of strategy into existing offer. Most importantly, the interpretation of heritage, as a new business strategy, could be fully based on the concept of sustainable development.

4. CONCLUSION

A small family hotel in Croatia has a large, but insufficient, tourist potential. It is therefore necessary to work on the design and implementation of new business strategies, primarily, if not exclusively, those based on the concept of sustainable development. Such strategy is the interpretation of heritage, which a relatively new trend in global tourism, which exceeds the standard, classical boundaries of creating tourism offer and is based on new, more attractive and creative ways of interpreting the natural, historical, cultural and other heritage of the tourist destination. The introduction of such content into the tourist offer of small family hotels would solve the problem of low profitability and seasonality of business, while at the same time it would set the foundation for building a specific destination as a brand. This approach is in line with new trends in tourism such as decline in interest in mass tourism, increased demand for exploring the destination, education on destination and personalization of the offer. However, even though practically all the resources for implementing a strategy based on the interpretation of heritage and sustainable development exist, the issue of professional staff remains, especially in Croatia. Some of the domestic tourism companies have already found the answer to these issues and they became the example of good practice, so there is virtually no obstacle for implementing such a business strategy, having in mind, of course, the complexity of the task.

LITERATURE:

1. Alfier, D. (2010.). *Zaštita prirode u razvijanju turizma*. Zagreb, Nebo d.o.o.
2. Črnjar, M. (2002.). *Ekonomika i politika zaštite okoliša*. Rijeka, Ekonomski fakultet
3. Gobé, M. (2001.) *Emotional Branding, a New Paradigm of Connecting Brand to People*. New York, Allworth Press
4. Gržinić, J., Vodeb, K. (2015.). *Cultural tourism and destination impacts*. Pula, Sveučilište Jurja Dobrile
5. Jelinčić, D. A. (2008.). *Abeceda kulturnog turizma*. Zagreb, Meandarmedia
6. Klarić, Zoran (2002.) *Razvoj ekoturizma i ruralnog turizma pridonosi slici Hrvatske, Okoliš*, br. 111, str. 11.
7. Križman Pavlović, D. (2008.). Marketing turističke destinacije. Pula, Sveučilište Jurja Dobrile; Zagreb. Mikrorad d.o.o
8. Moutinho, L. (2005.). *Strateški menadžment u turizmu*. Zagreb, Masmedia
9. Morgan, N., Pritchard, A., Pride, R. (2011). *Destinacija kao brend*. Beograd, CLIO
10. Nacionalni program razvoja malog obiteljskog hoteliterstva (2013.). Zagreb, Institut za turizam
11. Pavlek, Z. (2008.). *Branding: Kako izgraditi najbolju marku*. Zagreb, M. E. P. Consult
12. Porter, M. E. (2008). *Konkrentska prednost*. Zagreb, Masmedia
13. Sunara, Ž., Jeličić, S., Petrović, M. (2013.) *Održivi turizam kao konkurentska prednost Republike Hrvatske*. Stručni rad, Zbornik radova Međimurskog veleučilišta u Čakovcu, Vol. 4, No. 1
14. Vidučić, V. (2007.). *Održivi razvoj otočnog turizma Republike Hrvatske, Naše more: znanstveno-stručni časopis za more i pomorstvo*, Vol. 54, No. 1.
15. Zlatar, J. (2010.). *Odrednice turističke djelatnosti u smjeru održivog razvoja – primjer mjesta Povlja na otoku Braču*. Pregledni rad, *Sociologija i prostor: časopis za istraživanje prostornoga i sociokulturnog razvoja*, Vol. 48, No. 2 (187)
16. http://www.vijesti.rtl.hr/novosti/1091756/Korčula-proglasena-najljepsim-otokom-na-svijetu/
17. http://www.index.hr/black/clanak/hvali-ga-slavni-turisticki-portal-prelijepi-hrvatski-otok-je-novi-santorini/896882.aspx

18. https://www.tportal.hr/vijesti/clanak/dala-otkaz-i-od-pricanja-tajnih-prica-o-zagrebu-napravila-turisticku-atrakciju
19. http://www.muze.hr/novost/interpretirajmo-hrvatsku-hrvatska-udruga-za-interpretaciju-bastine
20. http://interpretirajmo-hrvatsku.hr/

THE IMPACT OF CONCESSIONS ON THE EFFECTIVENESS OF NEGOTIATION IN CROATIAN CAR SALES COMPANIES

Tomislav Galovic
Faculty of Economics University of Rijeka, Croatia
tgalovic@efri.hr

Patricia Zanketic
Municipality of Kršan, Croatia
patricia.zanketic@pu.ht.hr

Sandro Demo
Faculty of Economics University of Rijeka, Croatia
sandro.demo@hotmail.com

ABSTRACT

Croatian car market has been hit extremely hard during the economic crisis, resulting in a boom for used car sales. In year 2015 Croatia whole car market moderately rose albeit fast economic recovery. This research analyses the impact of given concessions on the effectiveness and competitiveness of car selling companies in Croatia. Car sales personnel in Croatia confront with non-effective negotiators/customers who often use win-lose strategy in business interaction. The main aim of this research is to identify the sources and effective concessions in order to improve productivity and competitiveness of car sales personnel/ companies in Croatia. Based on the results of secondary research conducted in Croatian cities like Zagreb, Rijeka and Zadar, negotiation concessions influence on the effectiveness of negotiation in Croatian car sales companies.

Keywords: *Competition, Croatian car sales companies, Effectiveness, Negotiation*

1. INTRODUCTION

The automobile industry is often called industry of all industries as for its complexity of the product and consequently for the impact it has on economy. After almost a century and a half of industrial production and hundreds of car producers nowadays there are about thirty megaproducers left. The 2008 crisis did not pass by the automobile industry. The number of sold cars was in decrease until 2013 when gradual recovery started. Since then the automobile sale started to improve and take the upward direction, i.e. from month to month the increase of sale has been recorded. The automobile industry is among the industries that have mostly sufferred from the consequences of the economy and financial crisis. With increase of unemployment the insecurity in keeping one's working place was present so that buying a car was postponed for some better times when money income would become more certain. This is why the demand for cars has diminished creating consequently a great number of produced cars and enormous stock filled up due to the decrease of demand. The sellers who could not sell their cars bankrupted while others had various strategies in order to survive the crisis. The european crisis reflected to the Croatian market as well. There has been a significant fall in the sale of new cars after the 2008 in the car industry. The buyers started to prefer the used cars as can be seen in the fact that the average car age in 2008 was around 9 years; nowadays the number has risen to 13 years old cars.

According to the above facts in order to make the car market more advanced, besides the buyers' income, it depends on the skills, abilities and comptencies of the car sellers themselves. The expertness in some basic rules as well as the concept of negotiation can considerably improve the sale. Business negotiation is very important for every company because it is a means by which improvement in company affairs can be achieved. This is why a solid expertness in business negotiation represents skills that each employee must possess in order to compete successfully in the work market. Fundamental preparation, quality approach and a wish to mutual satisfaction contribute a great deal in better possibility at achieving agreement with the client.

In the research the starting point is the hypothesis that the employees in using their knowledge in business negotiations are more successful in reaching agreement in negotiations with the clients in motor vehicles industry. While negotiating they dispose with concessions, i.e. additional possibilities to be offered to the client in order to persuade them to buy a car. Some concessions are used in advance with the purpose to „attract“ the client, and later on in the course of negotiations if estimated that it will be useful and what kind of concession he may offer to the to the client. It is upon the salesmen to estimate which concessions to offer to the customer. The subject of the research is deducted from the above mentioned statement being at the same time the object of the same research, concessions and their role in the car sale negotiations.

Identifying and determining the matter, both the subject and object of the research, the following work hypothesis is being placed: the use of concessions during the negotiations with the car buyers leads to a more successful realization of the sale, higher seller's efficiency and productivity and finally higher company's profitability. The purposeof the resarch is to detemnine the importance of the concessions in the efficient negotiation in car sale and to see in what extent they influence the efficiency, employee's productivity and a more successful car sale.

The structure of work consists of five interacting units. Following the ***Introduction*** the second paragraph deals with the analytical aspects of the motor vehicle market in Republic of Croatia and the European Union. The third paragraph includes the research methodology. The fourth paragraph named ***Results*** represents the results of the research carried out. In the fifth paragraph a conclusion is formed with suggestions for the sale improvement.

2. ANALYTICAL ASPECTS OF THE AUTOMOBILE MARKET IN CROATIA AND EUROPEAN UNION

2.1. The automobile market in Croatia as the member of the European Union

In January 2017 there were 406 (16.7%) registered cars more than in January 2016. In January 2016 there were 2.427 registered new cars compared to the 2017 rate of 2.833 units. Out of the total number there are 416 new VW cars sold, namely 14,7%. The number of registered premium vehicles has increased too. The Government introduced special taxes defined by the carbon dioxide emission rate, selling car prices, motor power and engine volume as well as the exhaust gasses emission. A special tax on used vehicles will be paid in the amount of the rest of special tax defined by the percentage of the decrease motor vehicle value on the croatian market. Due to this fact tha prices of most types of vehicles will increase, especially the cheaper models with weaker engines, older generation with greater CO2 emission.

After the exise increase the most sold type of vehicles is VW Golf 1.6 TDI (CO2 98g/km) is 300 kunas more expensive, Renault Clio 1.2 (CO2 127g/km) 7.500, Mercedes S 500 almost 38.000 kunas more expensive. The more expensive vehicles have become more expensive due to the increase of growth rate on luxury vehicles (more expensive than 600.000 kunas) ranging from 14% to 30%. Starting from september 2017 new growth in prices might be expected as the producers will be forced to quote the real and not adapted consumption achieved in ideal conditions.

Table 1: The number of registered vehicles in Croatia from 2013 to 2016 (http://www.acea.be, 2017)

Year	**Number of registered vehicles**	%
2013.	27.802	-
2014.	33.962	22.16
2015.	35.715	5.16
2016.	44.106	23.49

In Croatia in 2015 there were 35.715 newly registered vehicles, in 2016 44.106, i.e. 23.49% more than in 2015. It would have been a good increase if in the buyers' structure were at least one half of private buyers, but the share of private buyers amounts to 30.6% (13.507 vehicles) while legal persons represent the 69.4% (30.599 vehicles). In the years preceding the crisis (2008) there were 88.000 new vehicles where the private buyers were represented with a rate of 60%. Expectations were that the following two years would reach a number of more than 100.000 sold new vehicles, but we witnessed that the year 2009 brought only one half of the expected sale. The average car age was 9 years, nowadays it increased to 13 years of age.

In the Table 2. A list of top 10 sold vehicles in Croatia in 2016.

Table 2 : TOP 10 list of the most sold vehicles in Croatia in 2016 / in the first 7 months (http://autonet.hr, Promocija Plus)

Ord. Nr	Car/ vehicle model	Number of sold cars in 2016
1.	Volkswagen Golf	1523
2.	Renault Clio	1444
3.	Opel Astra	1327
4.	Ford Focus	1314
5.	Škoda Octavia	1225
6.	Suzuki Vitara	953
7.	Volkswagen Polo	898
8.	Opel Corsa	848
9.	Volkswagen Passat	768
10.	Ford Fiesta	674

The most sold car in the last consecutive 6 years is Volkswagen, its most sold model being Golf. Volkswagen is also the most requested of the used vehicles with a 21.41 % share. It is followed by Opel, Renault, Škoda, and Ford while the Suzuki takes the 6th place. The Suzuki's model Vitara is the most sold vehicle in Croatia of this producer.

Njuškalo.hr is the biggest internet announcer in Croatia announcing the used vehicles sales. In January, according to their analisys, about 13.000 used vehicles were sold. The buyers could choose between 63 types of car makes and 779 models of the vehicles announced. In the offer of used vehicles the Volkswagen was the most represented with a 16% rate.
The second place took Renault with 8% followed by Opel, BMW, Mercedes and Audi. Classified by the type of fuel the 71% are driven by diesel while the 29% goes for the petrol fuel (Njuškalo.hr, 2017).

In January the minimum passenger vehicle price was 930 kunas. Compared to the price for a new vehicle the price for a new one-year old vehicle was by 22% lower while the five-year old vehicles were 48% cheaper with regard to new ones. With regard to a great number of vehicles produced etween 2006 and 2008 the prices were from 58% to 68% lower (Njuškalo.hr). In the overall Njuškalo offer the biggest rate is of cars produced between 2010 and 2016 (38%) together with the ones produced between 2005 and 2010 (32%). The 70% of the vehicles is not older than 10 years.

2.2. The EU motor vehicle market

The automobile industry has been improving in the last several years with positive trends recorded (Bilas et al 2013, p. 313). The automobile producers will be faced with numerous challenges in the years to come and due to this it will be neccessary to effect significant restructurations with the aim to adapt the production capacities to the demand changes.

Some of the challenges are (Bilas et al, 2013, p. 313):

- Higher fuel prizes will probably accelerate the production towards the development of smaller and most economical carswith smaller profit margins,
- The majority of the sale will occur in the developing countries while a stagnation will be expected in the most developed countries,
- A permanent search for cheaper resources will continue having its aim lowering the expenses of multinational companies.

The Chart 1 five leading world car producers are presented for the 2015 and 2016 year.

Chart following on the next page

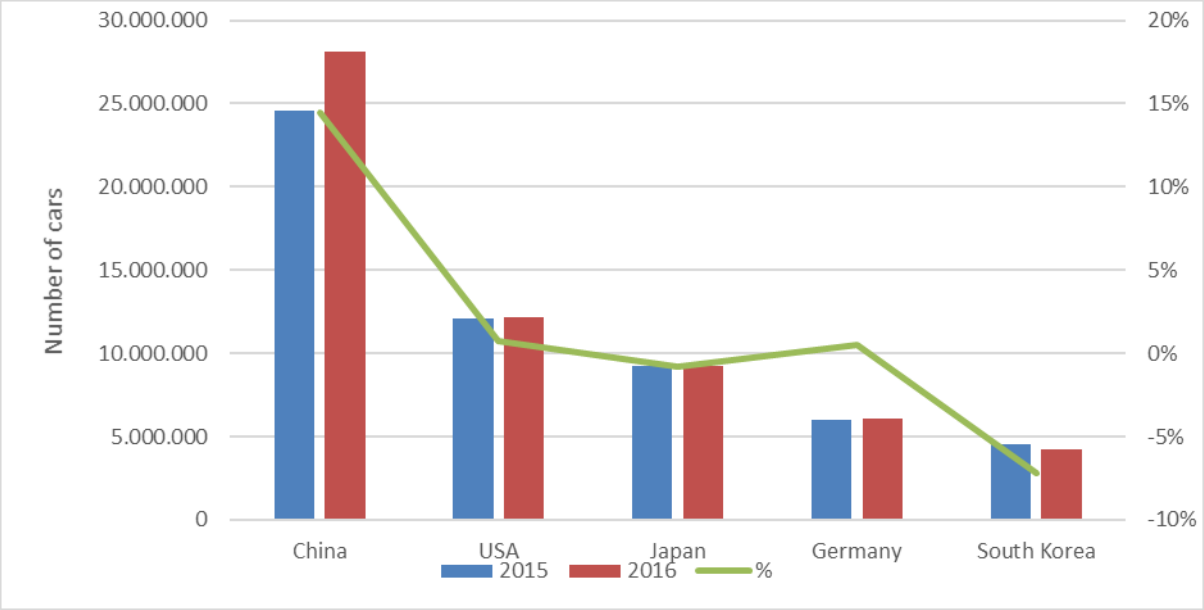


Chart 1: The biggest world car producers in 2015 and 2016 year (http://www.acea.be, 2017)

From the global aspect, China is the biggest world car producer, followed by the USA, Japan, Germany and South Corea. China has increased its production for 16% in relation to the 2015 so it continued keeping its leading position of the biggest power in the world.
Today there is almost no producer that did not start the production in China, in the first place owing to cheaper labour. In Europe Germany is still dominant and boasts with 46 factories of the total 293 in Europe.

The Table 3 shows the total number of registered new cars in European countries.

Table 3. The number of new registered car sin Europe 2007- 2016 (http://www.acea.be, 2017)

YEAR	NUMBER OF REGISTERED NEW CARS	%
2007	15.573.611	-
2008	14.331.792	-7.97
2009	14.157.752	-1.21
2010	13.372.917	-5.54
2011	13.148.076	-1.68
2012	12.051.805	-8.34
2013	11.873.302	-1.48
2014	12.542.492	5.64
2015	13.696.221	9.20
2016	14.627.789	6.80

According to the European producers' association (ACEA) the total number of registered new cars was 14.627.789 making the 931.568 cars i.e. 6.80 more than in 2015. The chart also shows that since the beginning of the crisis, starting in 2008, the number of new registered cars in European union falls until 2014 when the growth of 5.6% in relation to the previous year was recorded. The growth of new registered cars will also be recorded in the two following years for 9.20% and 6.80%.

The car sale in the EU countries has been growing in the last three consecutive years. Even in the year 2016 a slight fall in sale than the previous year was recorded it is regarded as a stability in growth.

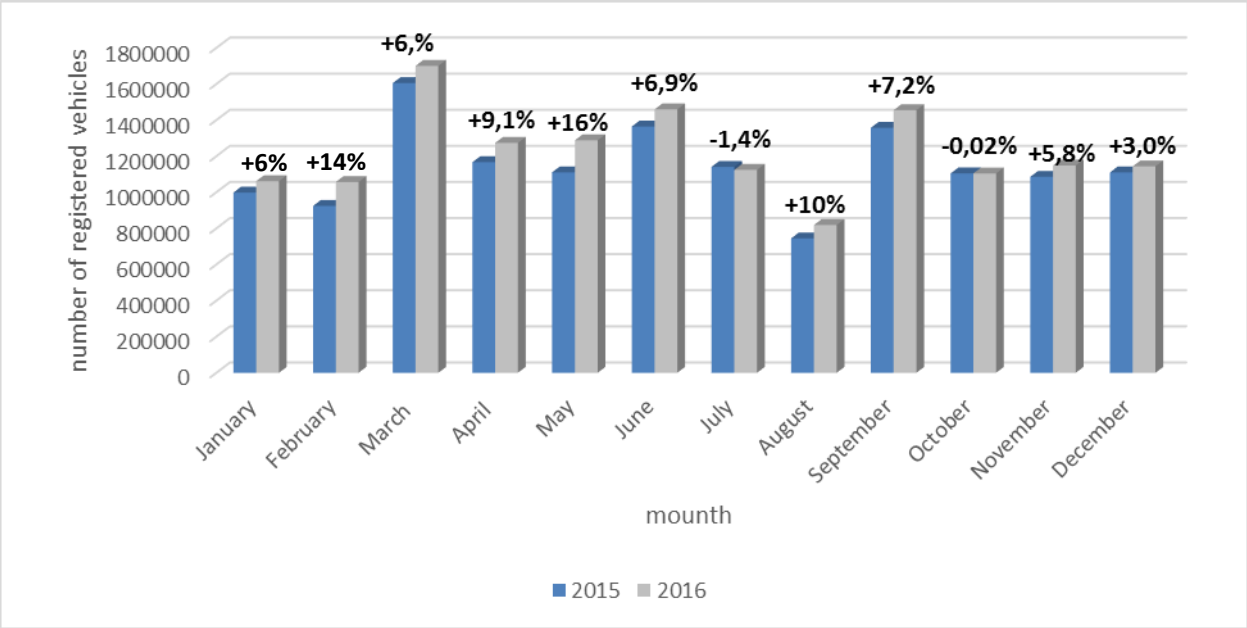


Chart 2: Monthly regitration of new cars in the EU countries in 2015 and 2016 (http://www.acea.be, 2017)

The car market in EU registers increase of car sale in each month of 2016 in relation to 2015 except in July and October with a light decrease in sale. Most cars were sold in March (1.700.674) and in June (1.459.508), and the lowest sale recorded in August (819.126 in 2015). The leading car model in car sale in the last four years has been Toyota, being overtaken by Volkswagen taking the leading position. In 2016 Volkswagen sold 10.31 millions of cars, while Toyota sold 10.18 millions of cars (HINA, 30.01.2017)

3. METHODOLOGY

The objective of this research is to prove that the concessions are a very strong tool in the sale of cars and along this what concessions are mostly used by the salesman and which are most attractive to the buyers. The research was implemented in the Republic of Croatia and was carried out during March 2017. In cooperation with the salesmen in the car shops on the Croatian territory by method of survey. It was realized on a model of 163 salesmen who, in the course of their job havea direct impact in the sphere of negotiations and stipulating negotiations with the potential buyers. The survey was conveyed with both male and female persons of various ages, different education levels and various years in the field of sale

experience. Data was collected in a surveying employees in particular car shops. A number of employees got the survey in electronic form, others were surveyed by interview method.
The results were introduced manually in the chart. The first six questions are general aiming at the sex, age, qualification, period of sale experience and the number of sold cars. The rest of ten questions are focused on sale, negotiations and concessions. The salesmen answered the questions by marking one or more of the offerred answers.

4. SURVEY RESULTS

Below you will find the results of the implemented survey in car shops. Analysing the results of the implemented survey by means of questionnaire we shall try to create a conclusion on the importance of concessions in selling of cars. The results are related to sex, age, qualification…

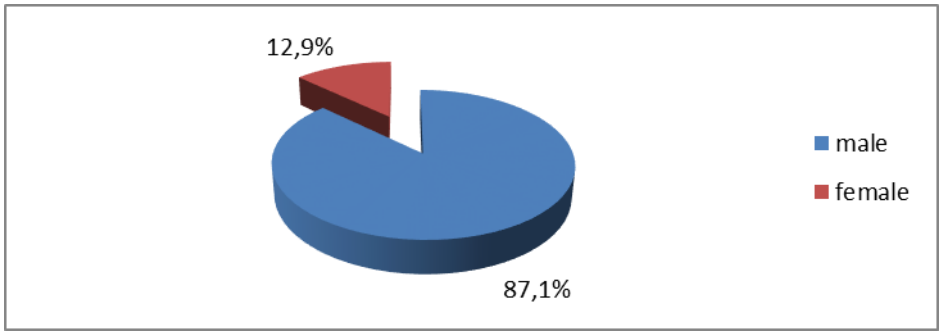


Chart 3. Sex of the surveyed salesmen (The author)

According to the survey results we come to a conclusion that the male sex is dominantly represented in the car sale. Among the surveyed there were 87.1% of male and only 12.9% female employed in the car sale.

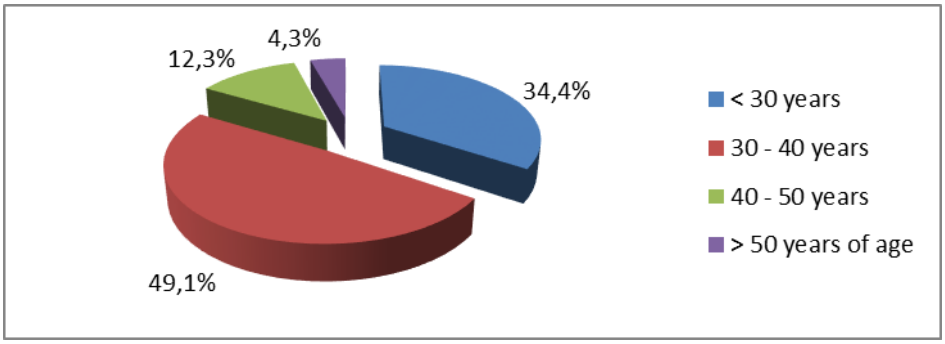


Chart 4. Age of the surveyed salemen (The author)

The majority of the surveyed salesmen is of the age between 30 and 40, i.e. 49.1%. The salesmen younger than 30 years of age are represented by 34.4% of the population while the 12.3% refers to the ages ranging from 40 and 50. The survey also shows that the salesmen older than 50 represent only 4.3% of man power.

Chart following on the next page

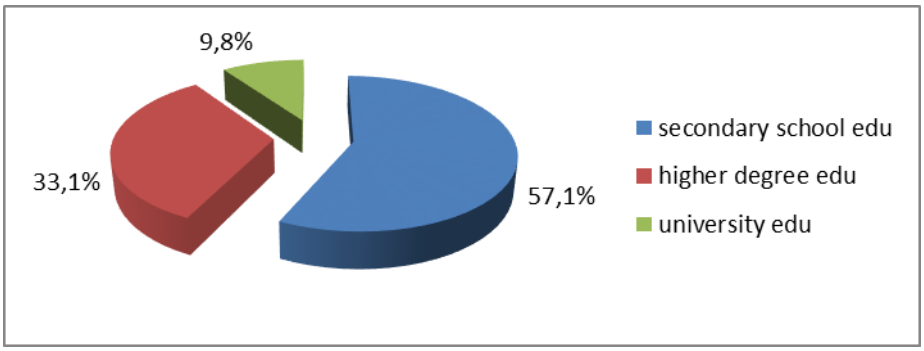


Chart 5. Qualification of the surveyed salesmen (The author)

Out of the total number of the surveyed salesmen 57.1% have the university education, 33.1% with higher degree education and the lower group of 9.8% have secondary school education.

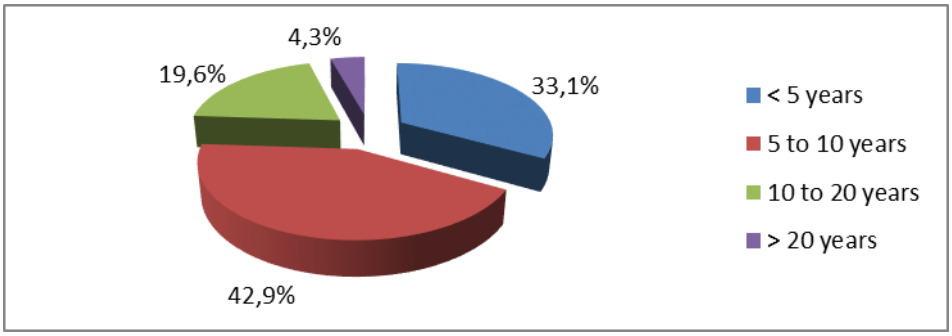


Chart 6. Working experience of the salesmen in sale of cars (The author)

There are 33.1% of salesmen in the ages of less than 5 years. The most represented group of salesmen make the 33.3% and are from 5 to 10 years of working experience, followed by those with 10 to 20 years of experience representing the 19.6% of them. The most experienced make the smallest group of 4.3% with more than 20 years of experience in the sale of cars.

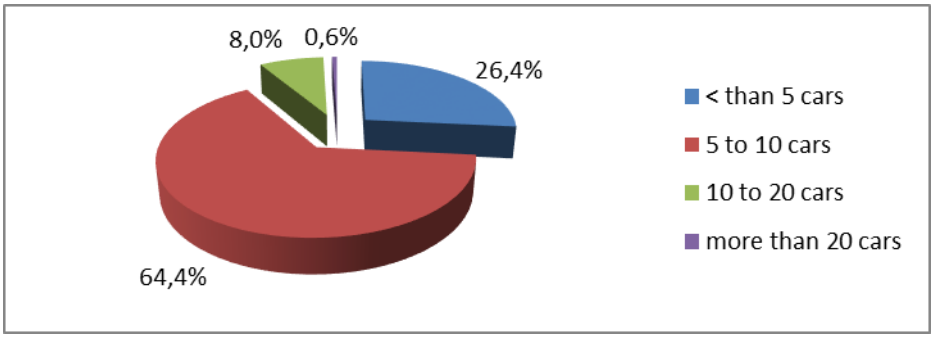


Chart 7. The number of sold cars monthly (The author)

The most numerous group of salesmen have sold between 5 to 10 cars a month, i.e. 64.4% The smaller sale (to 5 cars a month) is represented by 26.4% of the total sale. The salesmen who sell between 10 and 20 cars make the group of 8% of salesmen and finally only 0.6% salesmen sell more than 20 cars a month.

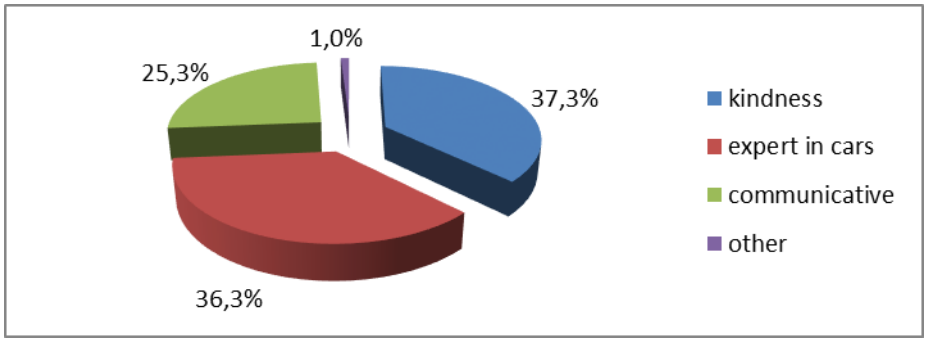


Chart 8. The most important quality that a car salesman must have (The author)

Most of the surveyed salesmen agree that kindness 37.3% and beeing familiar with a car 36.3% are the most important qualities a salesman should have. A high percentage goes to the beeing communicative with 25.3% : only 1% of them has the opinion that there is some other quality too that was not mentioned in the survey.

After the 6 introductory questions that helped to discover the general information on the salesmen such as sex, age, working experience… we pass on to the questions connected with concessions and negotiation in the sale process.

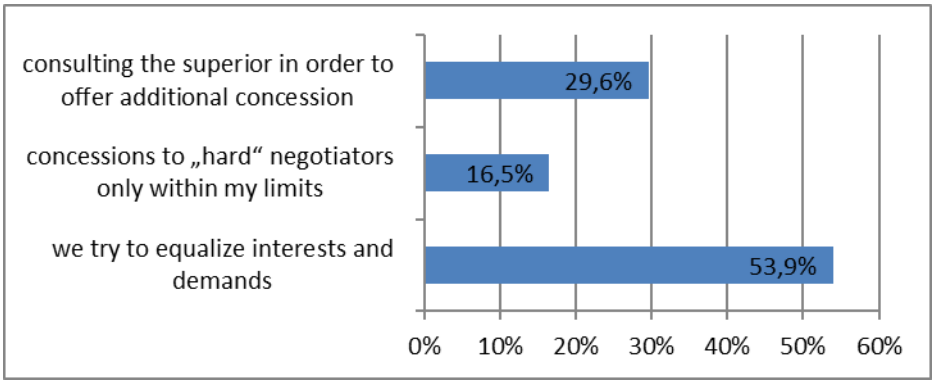


Chart 9. Anwer to „hard“ negotiation (The author)

According to the answers achieved we can conclude that 53.9% of the salesmen are trying to equalize interests and demands, while 29.6% of them need to consult their superior in order to offer an additional concession. The 16.5% of salesmen offers the „hard“ negotiators some additional concessions within their limits of decision and they do not cross the line.

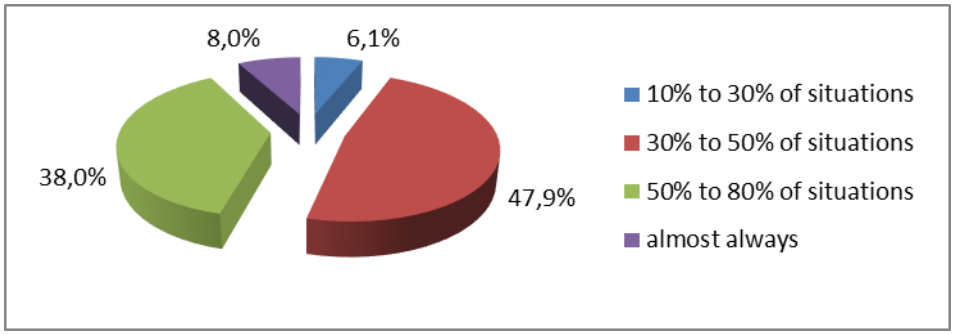


Chart 10. Frequency of "hard" negotiation in the sale of cars (The autor)

According to the achieved answers we can conclude that the salesmen often meet „hard“ negotiators. Out of all the surveyed salesmen 6.1% of them meet them in 10% to 30% situations, 47.9% in 30% to 50% situations, 38.0% in 50% to 80% and the 8% of them almost always.

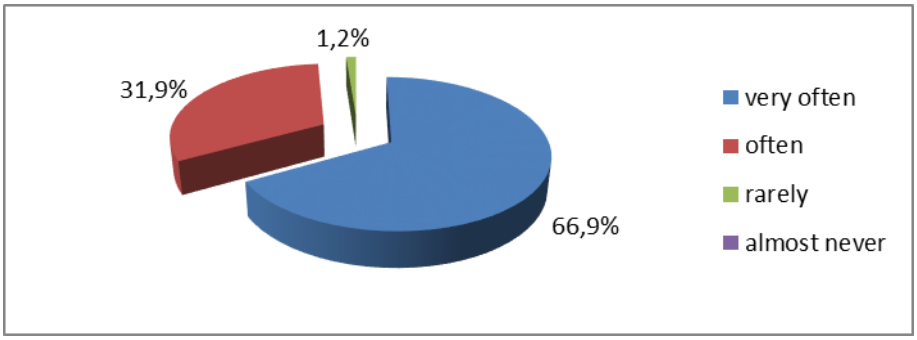


Chart 11. Frequency of using concessions in negotiations with customers (The autor)

According to the achieved answers to the question how often they use concessions we can conclude that the concessions are very important and often used considering that 98.8% of salesmen answered with often and very often, while only 1.2% answered that they rarely use concessions.

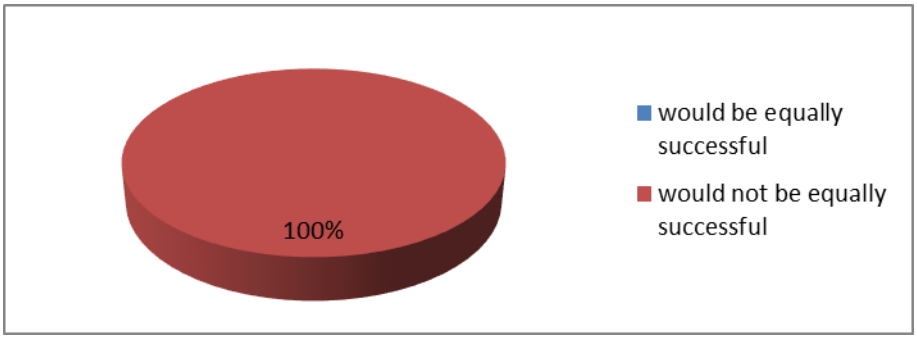


Chart 12. Would you be equally successful if not concessions (The author)

The salesmen agree and answered that without concessions they would not be equally sufficient in selling cars, i.e. concessions (and additional offers) increase their sale success. Based on the answers we can conclude that using them leads to a better success.

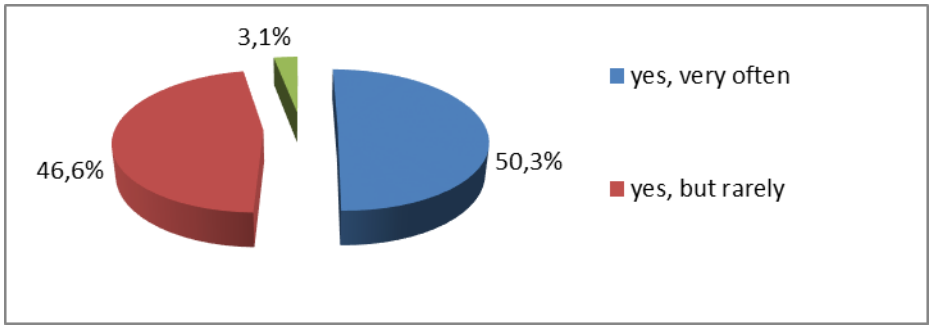


Chart 13. Is the price reduction the option you use in negotiations? (The author)

Price reduction is a frequently used concession. The 50.3% of the surveyed salesmen often use the price as an additional concession in order to improve the sale, the 46.6% of them use the price but very rarely. The price reduction is not the subject of negotiation aacording to 3.1% of them.

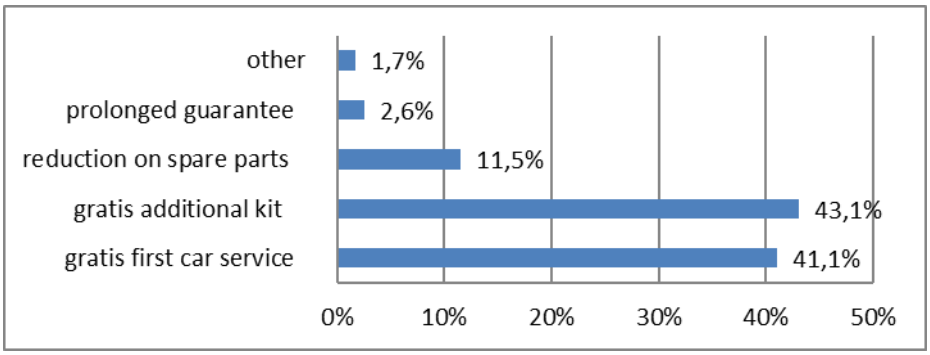


Chart 14. Concessions used in sale (The author)

The most used concessions are gratis service (41.1%) and gratis additional kit (43.1%). The reduction on spare parts is used in a smaller rate (11.5%), the prolonged guarantee (2.6%) and other (1.7%).

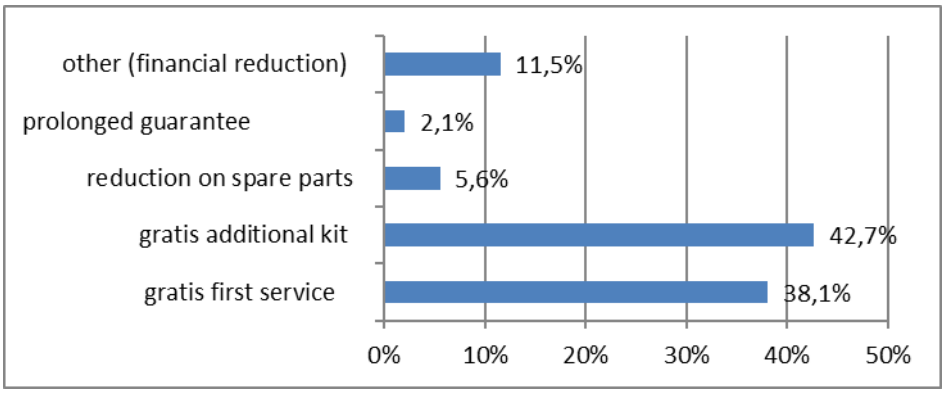


Chart 15. Concessions mostly preferred by customers (The author)

The customer is mostly attracted by additional kit (42.7%), gratis first service (38.1%) while reducion on spare parts is 5.6% and prolonged guarantee (2.1%) but regarding the answers of the salesmen on the previous question less used concessions. A part of the salesmen (11.5% of them) thinks that besides the named options, they prefer the financial reduction that was not offered as an option in the survey.

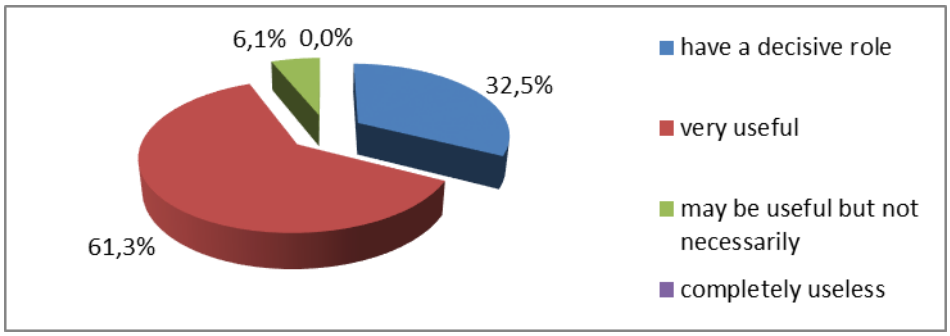


Chart 16. The importance of concessions (additional possibilities) in sale (The author)

The importance of concessions in the sale of cars shows the answer on the question nr 14 with 61.3% of salesmen state that they are very useful, the 32.5% of the think that they have a decisive role in the negotiation matter.

Only 6.1% of them consider that they may but do not have to be useful and no one of the salesmen did not declare himself that the concessions are useless.

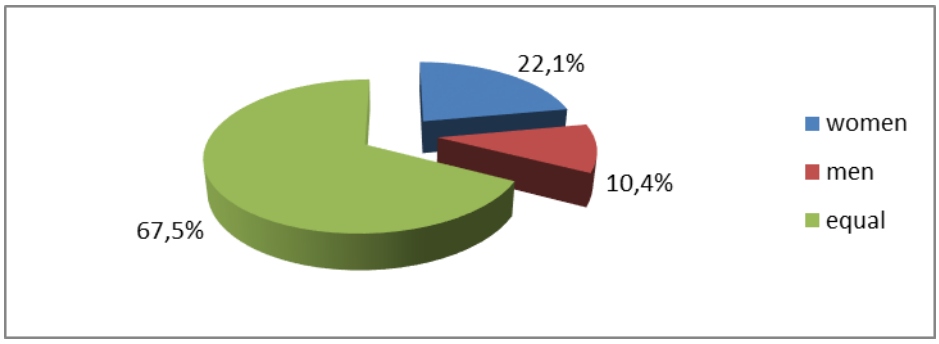


Chart 17. „ Easier“ negotiators (The author)

The 67.5% of the surveyed salesmen think that there are no differences between men and women in negotiations, while 22.1% of the salesmen underline women as „easier“ negotiators and 10.4% of then men. After the implemented and analysed survey we can conclude that the concessions are frequently used as a tool in the sale of cars and are very helpful to the salesmen during sale.

5. CONCLUSION

The automobile industry is one of the biggest and most impotant industries in the world automobile producers are among the biggest world companies. The automobile industry is the crucial component of the economic growth. Some of the reasons are: a great number of employed, a great consumer of goods and other services of other sectors. The world economic and financial crisis that started in 2008 severely affected the car industry so much that even the relevant Governments had to intervene. The help appeared in the form of more favourable credits and guarantees, subventions programmes in changing the old for new cars… The crisis has severely influenced the automobile industry. Due to uncertainty the consumers postponed buying automobiles resulting in higher offer that, together with the lower demand, resulted in decline of a part of producers. The stagnation is expected in mature markets as Europe and North America while a increased sale is expected in China but in the Indian market as well. It is predicted that in the countries with higher income, due to the overstocked market, the number of cars will change very little. In Japan the sale will stagnate owing to the reduced number of population, while at the same time in Germany and Italy the sale trend is expected to remain on the same level. In France, Great Britain and USA the sale trend is expected to rise due to the rise of population number as well as the number of cars per inhabitant. The combination of a small rate of number of cars per inhabitant and a great elasticity of income and its speedy growth results with a rising trend of sale in China and it is predicted that China, considering the number of sold cars will probably overcome the USA in the years to come and become the largest world car market (Bilas et al, 2013, p. 313). Considering the prediction related to the car sale a great challenge and hard work is put in front of the salesmen in the future. The car sale is big and financially very demanding investment for the buyers The preparation in communicating with the customers is crucial for the operating of automobile companies. Investing in verbal communication can considerably enforce the communication skills of the employees that infleuence the higher satisfaction of the customers. Finally, a satisfied customer not only comes back but continues to additionally promote the company (Galović, 2016, p. 15) The proved importance of concessions in car sale is being worked on. Besides the fact that the salesmen will have to improve and constantly invest in their knowledge and skills, they will always have to have attractive concessions fot the customers. Because of the general situation in relation to the car sale and

the crisis, the prices of cars are considerably lowered and the profit margins not so hugh as the used to be in the past period so that the space for addtitional reductions is not so large even if being the most attractive for the customers.
The customers might be offerred more favourable credits with the least possible interest rates. Some less investments as buying the mobile phone, car registration, .. are possible to buy on rates without interests. Here we deal with drastically smaller investments but it is surely possible to enable most favourable credits when buying a car. Speking about the sale of used cars the reduction of prices is possible considering that the profit margins are higher. The customers who decide to buy a used car decide to buy it as the financial reduction is the most important. It is due to the lack of resources that people decide to buy the used and not a new car. Even if the test drive is used they should become an integral part of of the negotiations as the customers would have a different feeling if having the possibility to test the car they are intersted in. They might also decide for a more expensive car if they were delighted during the test drive. A possibility is also to introduce a drive on a day, two or three.

***ACKNOWLEDGEMENT**: This work been supported in part by the University of Rijeka under the project number 16.02.2.2.01*

LITERATURE:

1. Cohen, S. (2000). *Vještina pregovaranja za menadžere*. Zagreb: Mate.
2. Fisher R. i Ury W. (1981). *Getting to Yes, Negotiating Agreement Without Giving In*. Boston/New York: Houghton Mifflin Company.
3. Kennedy, G. (2000). *Everything is Negotiable, How to get the Best Deal Everytime*. London. Random House Business Books.
4. Lewicki, R. J., Saunders, D., i Minton, J.W. (1999). *Negotiation* (3rd ed.). Boston: Irwin/McGraw-Hill.
5. Rosić, V. (2008). *Komunikacija, pregovaranje i lobiranje*. Rijeka: Institut za istraživanje i razvoj obrambenih sustava.
6. Segetlija, Z. (2009). *Poslovno pregovaranje*. Osijek: Ekonomski fakultet Sveučilište u Osijeku, Osijek
7. Tomašević Lišanin, M. (2004). *Pregovaranje – poslovni proces koji dodaje vrijednost*, Zbornik Ekonomskog fakulteta u Zagrebu (Vol. 2 No. 1.). Zagreb: Ekonomki fakultet
8. Tudor G. (2005). *Veliki poslovni pregovori*, Zagreb: MEP d.o.o..
9. Tudor, G. (1992). *Kompletan pregovarač: umijeće poslovnog pregovaranja*. Zagreb: MEP Consult.
10. *2014 Production statistics*. (2015). Retrieved 04.04.2017 from https://goo.gl/YpWxxL
11. *Auto moto: Najviše rabljenih automobila na prodaju proizvedeni su između 2006. i 2012.* (2017). Retrieved 04.04.2017. from http://blog.njuskalo.hr/auto-moto/najveca-ponuda-rabljenih-osobnih-automobila-proizvedeni-izmedu-2006-2012.
12. *Consolidated Registrations - By Country*. (2017). Retrieved 04.04.2017 from http://www.acea.be/statistics/tag/category/by-country-registrations.
13. *Novi osobni automobili- modeli*. (2017). Retrieved 04.04.2017 from http://autonet.hr/wp-content/uploads/2017/01/autonet_HR_trziste_2016-12.pdf
14. *Od 1. siječnja 2017. uvodi se plaćanje posebnog poreza na rabljena vozila.* (2016). Retrieved 03.04.2017 from http://www.poslovni.hr/hrvatska/od-1-sijecnja-2017-uvodi-se-placanje-posebnog-poreza-na-rabljena-vozila-321662.
15. *Volkswagen premašio Toyotu po prodaji automobila u 2016.* (2017). Retrieved 30.01.2017 from https://www.hina.hr/vijest/9409897.

THE ROLE OF NON-FORMAL QUALIFICATIONS IN THE FLEXIBILITY OF EDUCATION AND LABOR MARKET

Toni Popovic
PhD Candidate
Faculty of Humanities and Social Sciences, Split, Croatia
Department of Sociology
tpopovic1@ffst.hr

Renata Relja
Faculty of Humanities and Social Sciences, Split, Croatia
Department of Sociology
rrelja@ffst.hr

Tea Gutovic
PhD Candidate
Faculty of Humanities and Social Sciences, Zagreb, Croatia
Department of Sociology
tgutovic@gmail.com

ABSTRACT

The expansion of global market and the fragmentation and permanent changes in demand have led to fluctuations of the workforce in the contemporary labor market. Lifelong learning is imposed as an answer to market needs, providing flexibility of the workforce by additional qualifications gained through non-formal and informal learning. The standardization of non-formal qualifications has become an important topic in the European Union, and is increasingly being considered as a way to raise workforce competitiveness, visibility and mobility. According to the Eurobarometer (2014), a significant proportion of the European market stakeholders considers a single European area of skills and qualifications necessary and stresses the need for further unification of standards with countries outside the EU. The Croatian Qualifications Framework Act (2013) prescribes the establishment of a system of recognition and validation of non-formal and informal learning, taking into account all the knowledge and skills an individual gains, either in the adult education system or by developing one's own entrepreneurial ideas. By recognizing non-formal qualifications, these forms of learning gain in importance and become a factor of labor market flexibility due to various standardized (required) qualifications alongside those acquired through formal education. The Strategy of Education, Science and Technology (2014) points to adults who have life and work experience as the main target group of such standards, considering that the proper validation of living experience would clearly contribute to the harmonization of market needs and competences acquired through different forms of learning. The uniformed validation of non-formal qualifications encourages personal and professional development, but also requires a high degree of cooperation of the entire education system and the labor market, the involvement of market stakeholders in the development of non-formal education curricula, as well as the elaborated glossary and certification system of various forms of non-formal education. The purpose of this paper is to present the perspectives of a validation system for non-formal qualifications in Croatia with regard to the EU context, as well as the role of this system in training competitive, business-oriented individuals and increasing the labor market flexibility.

Keywords: *entrepreneurship, labor market, lifelong learning, non-formal qualifications, workforce*

1. INTRODUCTION

Modern society increasingly focuses on human capital, determining the "knowledge society" as the main response to the growing needs of education, economy and the market system. The thesis on human capital-based economies as more viable and rapidly progressive is being largely accepted (Malhotra, 2003; as cited in Sundać, Fatur Krmpotić, 2009, p. 316). As the most easily measurable component of human capital, education has always been one of the pillars of modern society and can be defined as a "dynamic process that produces and ensures individual knowledge and skills" (Bečić, 2014, p. 214; Kuka, 2012, p. 198). Numerous studies consider the relationship between education and the labor market, i.e., changes in education due to the growing needs of a globalized market. According to the sociological understanding of post-Fordist work organization, the purpose of contemporary education is to create an entrepreneurial culture in which an individual becomes competitive at a global level due to his or her adaptability to changing organizational conditions (Brown, Lauder, Ashton, 2008, p. 139).

Today, education is considered to be one of the main determinants of wage levels and it greatly influences the supply and demand in a market (Bečić, 2014, p. 214). The importance of lifelong learning has been highlighted by the European Union in the *Lisbon Strategy* and the *Memorandum on Lifelong Learning*, which emphasize employability and active citizenship as the main goals of this process (Commission of the European Communities, 2000, p. 3-5). Lifelong learning includes formal, non-formal and informal education. A flexible market makes it virtually impossible to stay in the same workplace over a lifetime, making the progress of an individual largely dependent on the qualifications acquired beyond the system of formal education. Besides, workplace learning becomes necessary and diverse, as many organizations take a flexible form to adapt to a competitive environment (Relja, Popović, 2016, p. 222). According to the recent Eurobarometer data, most European market stakeholders consider it necessary to develop a single *European Area of Skills and Qualifications*, and stress the need for further equalization of occupational standards and qualifications with non-EU countries (European Commission, 2014, p. 6-7).

The current labor market and employment trends have been influenced by socio-economic transition and changes in division and organization of labor (Mrnjavac, 2002; as cited in Kitić, Miljak, Lozić, 2012, p. 53-54). Nevertheless, the current "knowledge economy" places the level of workforce education in the foreground. People who quit or lose their jobs should be trained to re-enter the labor market and transfer their knowledge to new jobs, providing the continuous opportunity to participate in further education and acquire new competences (Gutović, 2016, p. 245). The unique national as well as the European validation system for the qualifications acquired through non-formal and informal education would enable better visibility and utilization of acquired knowledge, skills and competences, making the lifelong learning process useful to a much greater extent (Sundać, Fatur Krmpotić, 2009, p. 317; Colardyn, Bjornavold, 2004, p. 69). The aim of this paper is therefore to present the perspectives of the recognition, validation and standardization system for non-formal qualifications in Croatia with regard to the EU context, as well as the role of this system in training competitive, business-oriented individuals and increasing the labor market flexibility.

2. STRATEGIC FRAMEWORK FOR HARMONIZATION OF EDUCATION AND THE LABOUR MARKET

There is a growing gap between the knowledge and skills acquired through formal education and labor market needs. The *Copenhagen Declaration* (2002) clearly states that "lifelong learning and mobility strategies are of crucial importance in promoting employability, active citizenship, social inclusion and personal development" (European Commission, 2002, p. 2). In the European Union, each Member State is responsible for its own education system and the market situation. However, through its various funds, project calls, initiatives and measures, the EU offers support

in addressing the problems arising from social development, market expansion and fragmentation, and changes in demand, which are the processes on a (global) macro level with a strong influence on a (local) micro level. The global financial crisis in the last decade has further highlighted the weaknesses of the economy and society, eradicated the stable socio-economic values of growth and job creation, and has generally undermined the European labor market security (Perin, 2013, p. 151).

Europe 2020, the European Union's ten-year jobs and growth strategy, highlights the three key, mutually intertwined, market economy development priorities: smart, sustainable and inclusive growth. Smart growth is focused on the development of knowledge-based and innovation-based economies, i.e., on finding the responses to the growing challenges of the European market by investing in human capital development (European Commission, 2010, p. 5). According to the International Labor Organization, employability is defined as a set of knowledge, skills and abilities that enable an individual to acquire and keep a job, professionally advance in it, and to find a new job after a dismissal. It enables the labor market mobility at different stages of an individual's working life (International Labor Office, 2002; as cited in Perin, 2013, p. 148). In accordance with the neoclassical theory of human capital (Figure 1), education enhances the productivity of an individual, thus increasing financial income during the person's working life (Schultz, 1961; Mincer, 1974; Becker, 1975; as cited in Bečić, 2014, p. 215). The relationship between education and the labor market, i.e., the development of adequate knowledge and skills during education, in order to increase competitiveness in the labor market, is today one of the most important areas of the European Union's development, including the Republic of Croatia. A globalized society is increasingly insisting on a highly skilled workforce capable of competing outside the European market, particularly in the US and Japanese markets.

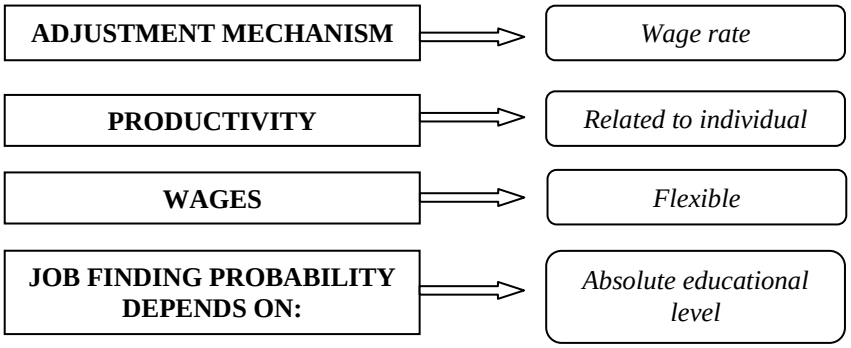


Figure 1: The Basics of Human Capital Theory
(Groot, Hoek, 2000; as cited in Bečić, 2014, p. 224)

Smart growth, highlighted as the *Europe 2020* priority, and the *Lisbon Convention* from 1997, are the basis of the European Commission's initiative called *Rethinking Education*. As a step forward in strengthening coherence and facilitating employment and workforce mobility, the initiative launched in 2012 with the purpose of reforming Member States' education systems highlights the transparency and validation of non-formal and informal education (European Commission, 2012, p. 8). According to sociologist Anthony Giddens, a contemporary man is faced with the "plurality of choice" followed by a sense of anxiety in realizing how traditional forms of learning, work and other life spheres do not provide adequate answers to the current insecure and flexible market situation (Giddens, 1991; as cited in Bezenšek, 2007, p. 203). In addition to the already developed standards in formal education (the *European Qualifications Framework* – EQF, the *European Credit Transfer and Accumulation System* – ECTS, the *European Credit system for Vocational Education and*

Training – ECVET and the *Multilingual Classification of European Competences, Qualifications and Occupations* – ESCO), the development of a unique European standard of validation of knowledge, skills and qualifications (the *European Area of Skills and Qualifications*) would therefore strengthen the links between the labor market and lifelong learning, providing an individual with greater competitiveness, security and employability (European Commission, 2012, p. 8). Non-formal education allows every person to participate a variety of programs that have not been sufficiently presented or available during formal education (Kuka, 2012, p. 201).

2.1 Flexibility or flexicurity of the labor market

The socio-economic conditions of the 21st century reduce job security. With fast-changing conditions of developed capitalist markets, it is difficult to expect permanent employment, job placement at the same workplace for most of the life, and financial security. Lifelong learning has become an answer to the changing knowledge configuration in the modern market, ensuring individuals a relatively stable income and reducing the risk of social exclusion (Relja, Bešker, 2011, p. 276). The labor markets around the world, as well as in most EU countries, assume the features of post-Fordism[1], i.e., the flexibility and dynamics of an individual are clearly noticed.

The labor market flexibility can be considered on a macro and micro level. While the latter relates more to tasks and wages within an enterprise, macro level flexibility means "market ability to quickly adapt to changing economic conditions, including mitigating the variety of external shocks affecting the economy" (Lowther, 2003, p. 459). The consequence of such an adjustment to the financial crisis affecting most of the economies since 2007 has been reflected in the increase in unemployment in most Europe (Figure 2).

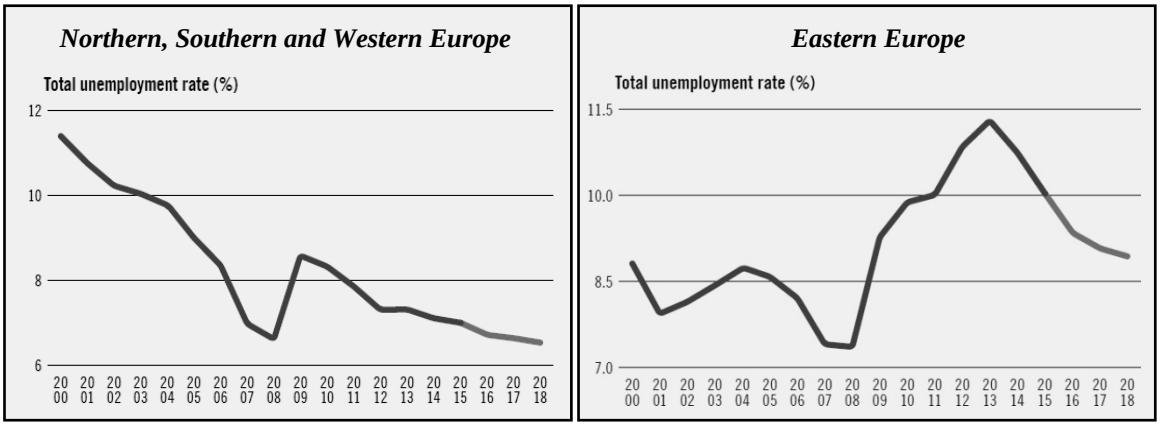


Figure 2: Unemployment rates in Europe
(International Labor Office, 2017, p. 50-51)

The effects of market flexibility on a macro level are discussed by economists and sociologists. The most common types of flexibility include employment, working hours, salaries and work organization (Lowther, 2003, p. 459). According to the International Labor Organization (ILO), increased market flexibility was not followed by market efficiency precisely because of lowering security and stability of employability (International Labor Office, 2002; as cited in Perin, 2013, p. 151). A modern man is faced with increased market dynamics, trying to improve his or her

[1] Post-Fordism is a term that describes the transition from mass production to more flexible forms of labor that encourage innovation and are directed towards satisfying individualized market needs (Giddens, 2007, p. 695).

competitiveness, mostly by investing in capital through non-formal and informal education. At the end of the 1990s, Dutch sociologist Andriaansen conceived the concept of *flexicurity* (flexibility + security = flexicurity). Danish experts were the first ones to apply it in a number of labor market reforms, while the European Union accepted it as an adjustment strategy to the conditions of increasing flexibility and reducing market security (European Commission, 2013, p. 13). At the beginning of the 21st century, flexicurity, i.e., the transition from a safe job to safe employability (Perin, 2013, p. 151) becomes a common term in European conventions and strategies to fight the unemployment and inequality between the rich and the poor. It is important to emphasize lifelong learning as one of the four areas where reforms are needed to implement flexicurity (European Commission, 2013, p. 13). Personal competitiveness depends on someone's knowledge and skills. Given the widespread lifelong learning, a favorable position in the labor market can be ensured through various forms of non-formal education alongside the formal. It means that, in addition to the knowledge and skills acquired through regular education, key competences for equitable market participation may be the result of non-formal education that enhances self-management skills, recognition of opportunities and individual's entrepreneurship (Kuka, 2012, p. 200; Perin, 2013, p. 152; Organization for Economic Cooperation and Development, 2001; as cited in Sundać, Fatur Krmpotić, 2009, p. 316).

3. CONCEPT OF NON-FORMAL EDUCATION AND THE IMPORTANCE OF NON-FORMAL QUALIFICATIONS

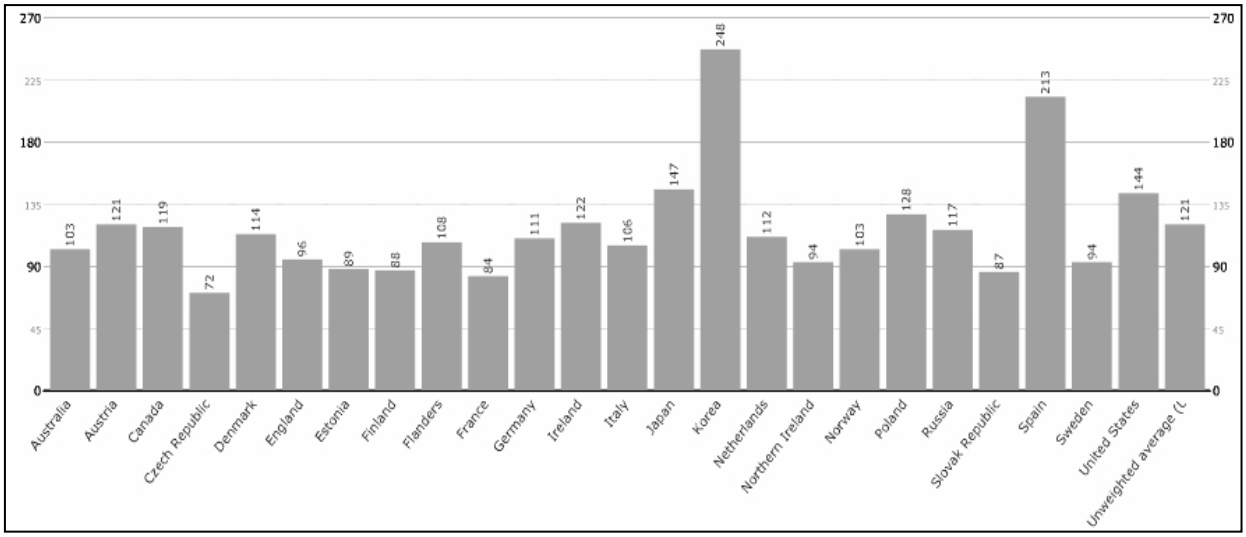
In addition to formal education (elementary and secondary schools, faculty), the concept of lifelong learning includes non-formal and informal education. Non-formal education covers organized learning for professional development, participation in social activities and personal growth (Adult Education Act, 2007). In 1972, UNESCO defined non-formal education as an organized activity outside the formal education that aims to meet learners' needs and learning objectives (UNESCO, 1972; as cited in Kuka, 2012, p. 200). Despite many definitions attempting to unite this concept in theory and practice, today's andragogists agree that it is a type of education that includes the acquisition of knowledge and skills related to work, social activities and private life. It takes place mainly in associations, companies, adult education institutions etc. (Kulić, Despotović, 2005, p. 120; Kuka, 2012, p. 198; Kitić, Miljak, Lozić, 2012, p. 54). It is a conscious and voluntary activity of an individual (Colardyn, Bjornavold, 2004, p. 71).

Over the last decade, the Council of Europe and the European Commission have repeatedly emphasized the role of this form of education in social development. The *Europe 2020 Strategy* considers non-formal education as crucial for young people entering the labor market (European Commission, 2010, p. 13). Furthermore, Marković points to the "non-formal" basis in non-formal education as "organized and planned activities beyond the formal education system that foster individual and social learning, the acquisition of various types of knowledge and skills, and the formation of attitudes and values. These activities are complementary to formal education. They are voluntary, and designed and conducted by trained and competent educators" (Marković, 2005, p. 11). In other words, non-formal education is a voluntary involvement of an individual of any age, gender, culture, ethnicity, race and work status in further learning in the form of various seminars, trainings, courses, camps, volunteer exchanges, conferences, lectures, project activities etc. (Kuka, 2012, p. 199).

The aforementioned forms of non-formal education have a common interest in increasing the opportunities of an individual in the labor market, as well as in "maintaining the necessary skills to carry out one's roles in the business process" (Zubović, 2010, p. 29). Such education is considered a prerequisite for further social development (Kuka, 2012, p. 201) as it seeks to accomplish several fundamental tasks: to provide education to the socially excluded or

marginalized, to grant new knowledge, skills and competences to rural population, to avoid cultural barriers in formal education, to use scarce resources available for education, and finally to contribute to formal education, i.e., school system (Kulić, Despotović, 2005, p. 118).

Although European conventions and decisions often target young people in the process of non-formal education, such educational programs are actually a part of adult education according to their form and students. Given their content and purpose, they often belong to entrepreneurship education, i.e., education aimed at strengthening individual market competitiveness and



opportunities for self-employment.

Figure 3: Average number of hours spent in non-formal education of people aged 24 to 65 (2012-2015) (OECD Survey of Adult Skills, 2015)

Given the relatively low participation rates in adult education at European level (Figure 3), as well as the lack of familiarity with entrepreneurial knowledge, the European Union highlights these areas as priorities in the current strategic documents. Considering the key competences for 2017, the OECD considers an appropriate education system as a basis for increasing employability by providing entrepreneurial skills and diverse knowledge since early childhood, through formal as well as adult education as a sort of non-formal education (OECD, 2017, p. 2). In this context, entrepreneurship is considered as an independent value orientation, the dimension of an individual ready for his / her own market venture, a state of mind that leads to personal development and progress (Krueger, 2007; as cited in Ratto-Nielsen, 2015, p. 131-132).

The development of entrepreneurial skills through non-formal education is emphasized as the task of implementing *Europe 2020*, whereby the European Commission insists on promoting the links between entrepreneurial education, adult education and non-formal education, and on enhancing individual competitiveness (European Commission, 2010, p. 13). Entrepreneurial education has been implemented in different types of adult education curricula in a number of EU countries, and the goal is to set entrepreneurship as a learning outcome of the non-formal education, i.e. the key competence for entering the labor market upon leaving education system (European Commission, EACEA, Eurydice, 2016, p. 21).

The education strategy of the European Union considers additional investment in adult education and acquisition of new competences, knowledge and skills in the workplace or through different types of learning as the priority of Member States. In addition, entrepreneurial education is set as a priority of formal but also other forms of education. In this regard, it is emphasized that each individual, along with basic, transferable and transversal skills, should be trained to

undertake an independent entrepreneurial venture. In order to reduce the gap between competences acquired through (formal) education and those sought on the labor market, assuming that 20% of jobs will require an even higher level of education by 2020, lifelong learning is recommended for improving skills, knowledge and general entrepreneurial (creative) thinking to secure a place in the European market (European Commission, 2012, p. 11-15).

It can be concluded that by developing a system of validation of non-formal qualifications, as well as promoting adult education through entrepreneurial learning outcomes, an individual in the European labor market increases competitiveness, mobility and the certainty of career advancement.

3.1 Validation of non-formal qualifications in the European Union

At the beginning of the 21st century, the Committee of Ministers has issued recommendations for further development of non-formal education systems in the EU Member States, on the basis of previous conferences and adopted European declarations on education. Apart from investments in non-formal education in general, recommendations include the institutional development and training of educators, incentive for Member States to recognize and unify the qualifications acquired through this type of education, and synergy between formal and non-formal education for the benefit of an individual (Council of Europe, 2003, p. 1-2). Furthermore, in 2012 the Council of Europe has shifted its attention from the process of non-formal education to the national and international validation systems of non-formal qualifications. It is emphasized that precisely the knowledge, skills and competences acquired through non-formal education play an important role in the competitiveness, mobility and employability, and can often be the decisive factor in entering the labor market (Figure 4). In order to provide equal opportunities for those who choose to train and improve through this type of education, the Council recommends that all Member States should develop a unified system for the validation of non-formal qualifications by 2018 at the latest (Council of European Union, 2012). It is an official recommendation that each Member State should set up a system based on "identification, documentation and assessment of the learning outcomes acquired through formal and non-formal education, as well as certification of learning outcomes in the form of qualifications or, where appropriate, in some other form" (Council of European Union, 2012).

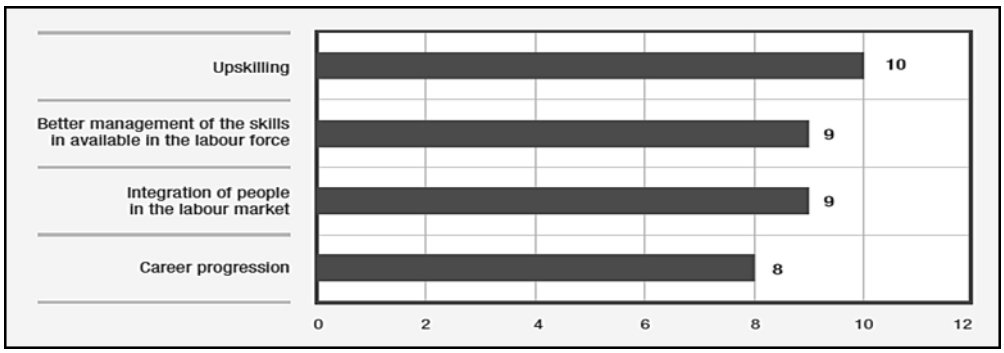


Figure 4: The main goals of validating non-formal qualifications in relation to the labor market (Cedefop, European Commission, ICF, 2017, p. 38)

The OECD and the European Center for the Development of Vocational Training (Cedefop) also work on refining these elements as a part of the system for validating non-formal qualifications. According to the OECD, the key advantages of validating non-formal qualifications are manifested at the individual and social levels. At the individual level, it is about the

development of human capital and investment in lifelong learning. Similarly, social benefits are manifested through the harmonization of education and labor market, investment in the system of lifelong learning, human capital development and economic competitiveness of individuals, as well as improvement of their psychological state by raising the importance of education in general (OECD, 2010a, p. 1).

Every four years, the European Center for the Development of Vocational Training (Cedefop) publishes the *European Inventory on validation of non-formal and informal learning*, taking into account the social situation of the analyzed countries, as well as their education systems, the labor market and civil society. Considering the policies of 33 European countries in 2016, Cedefop pointed out that countries take different approaches in validating non-formal qualifications (Figure 5). By comparing their legislative and institutional frameworks, all countries from the above-mentioned review have made significant progress in relation to the previous 2014 report, introducing notable changes and reforms in their education systems and legislations. However, some of them have developed national strategies that apply to all employment sectors, while others have shaped different strategies for different sectors, mainly developing sectors (Cedefop, European Commission, ICF, 2017, p. 14-18, 32).

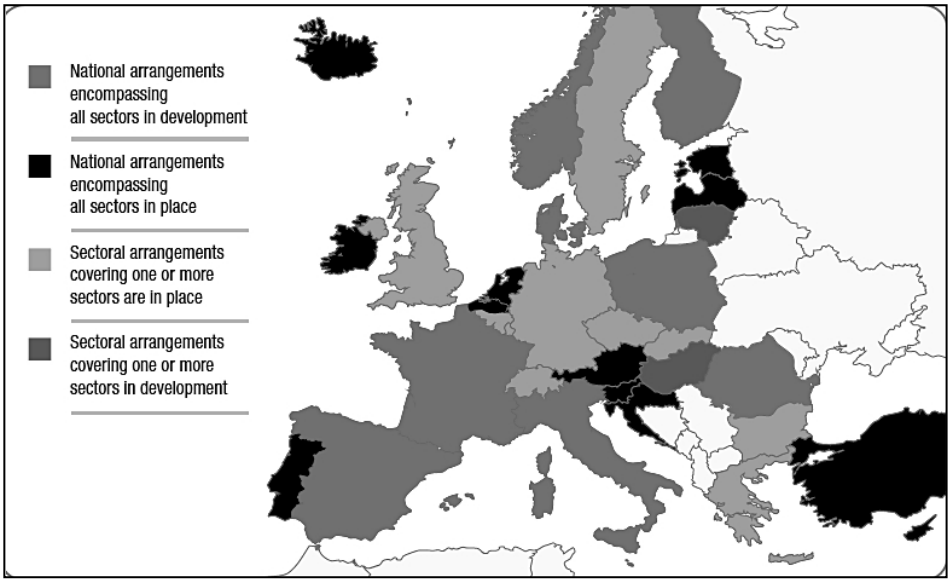


Figure 5: Validation of non-formal qualifications across Europe (Cedefop, European Commission, ICF, 2017, p. 33)

So far European policies have been making efforts to raise awareness of the legislative and institutional frameworks of Member States on the importance of non-formal qualifications. Their advantages are clear in fighting unemployment, improving individual competitiveness and reducing market uncertainty, and finally in developing the system of validation of non-formal qualifications acquired through various types of learning (OECD, 2010b, pp. 7-12). The most significant contributions are the establishment of the *European Qualifications Framework* (EQF), the *European Credit System for Vocational Education and Training* (ECVET) and the *Multilingual Classification of European Competences, Qualifications and Occupations* (ESCO). These systems ensure the necessary knowledge, skills and competences for a certain work position, enabling an insight on the required education for a particular job, and open the possibility of labor mobility, regardless of the country in which the education is acquired (Council of Europe, 2017, European Parliament, Council of the European Union, 2008, pp. 6-8; European Parliament, Council of the European Union, 2009, p. 1-8).

3.2 Legislative context of non-formal qualifications in Croatia

The validation of non-formal qualifications in Croatia was first mentioned in the 1960s when adults were in a position to obtain a publicly recognized certificate of a qualified and highly qualified worker by passing an exam in front of a commission. The so-called people's universities were in charge of the validation of qualifications, and this possibility existed until 1975 and the educational reform led by Stipe Šuvar[2] (Petričević, 2012, p. 101).

At the beginning of the 21st century, the Republic of Croatia renewed the question of non-formal qualifications prior to joining the European Union, and became a subject to European strategies, declarations and conventions on non-formal education with full membership on July 1, 2013. In legislative documents, the validation of non-formal qualifications in contemporary Croatia was first mentioned in the *Crafts Act* (49/03) and the *Ordinance on the Implementation of Apprenticeship Programmes and In-service Trainings for Crafts and on the Rights, Obligations, Monitoring, Assessment and Evaluation of Apprentices* (99/04). Upon its entry into force in 2003, the Crafts Act defined the Croatian Chamber of Trades and Crafts (HOK) as the major institution for the assistant and master craftsman's examination, and also granting a certificate for the program of vocational education (Crafts Act, 2013). Other areas of non-formal (re)training are defined by the *Adult Education Act* (17/07, 107/07, 24/10) and the *Vocational Education and Training Act* (30/09, 24/10, 22/13). The Adult Education Act determines that the institution responsible for the implementation of the (re)training program is also responsible for the completion of the final exam and the certification of a vocational qualification (Adult Education Act, 2007), while the Vocational Education and Training Act establishes a system of credit points that determine the scope of acquired vocational competences, whose occupational standards are aligned with the labor market needs every five years (Vocational Education and Training Act, 2013).

As a unique document that defines qualifications in the Republic of Croatia, the *Croatian Qualifications Framework Act* (22/13, 41/16) was adopted in 2013. It is a prerequisite for the transparency, mobility and quality of qualifications acquired through the Croatian education system and is aligned with the *European Qualifications Framework* (EQF) and the *Qualifications Framework in the European Higher Education Area* (QF-EHEA) (Vidak, 2016, p. 64). This Act defines a qualification as "a unified set of learning outcomes of certain levels, volume, profiles, types and quality, which is proved by a certificate, diploma or other public document issued by an authorized legal entity" (The Croatian Qualifications Framework Act, 2013). Despite the Croatian Qualification Framework, there is no single validation system of qualifications acquired through non-formal and informal education in Croatia. As one of the goals of the lifelong learning system, the most recent *Strategy of Education, Science and Technology* (2014) emphasizes the need for "developing a system of recognition of knowledge and skills acquired through non-formal and informal learning". Given the gap between formal learning outcomes and required job competences, the goal of the Strategy is to establish a validation system for non-formal qualifications in order to increase the quality of all educational levels, as well as the transparency of all knowledge and skills and their transition in a flexible labor market. The system should provide a better individual horizontal and vertical mobility. According to the Strategy, its formalization is envisaged after further analysis of the practices of other European countries. The process of validation of acquired learning outcomes is regulated in detail by the *Ordinance on Recognition and Validation of Non-formal and Informal Learning* and should be implemented in accordance with the Croatian Qualifications Framework (The Croatian Parliament, 2014, p. 34-36).

[2]Educational reform implemented by Šuvar is explained thoroughly in his book *Škola i tvornica: u susret reformi odgoja i obrazovanja*. It included the implementation of directed education, the partial suspension of grammar schools and the expansion of vocational-oriented secondary education (Šuvar, 1977, p. 112-113).

In order to bring this system into practice, within the educational framework of the Republic of Croatia and the changing labor market, Petričević offers a list of the necessary prerequisites: to create a glossary of non-formal and informal knowledge and skills, to integrate existing crafts laws into a coherent system, to set the system's goals and the age limits for individuals to access the validation process, and to determine the institutions that provide certificates and define qualification levels, learning outcomes and verification content. The system should be based on an individual's portfolio that contains numerous evidence of completed formal and informal education. Given the decision of the review committee on compiled portfolio, made in cooperation with the regional and local government, one would be awarded a certain degree of qualification needed to enter the labor market. Financing the process of validation of qualifications would depend on the work status of an individual. Costs could be covered by an applicant or employer, and if necessary by local communities and state budget (Figure 6) (Petričević, 2012, pp. 104-115).

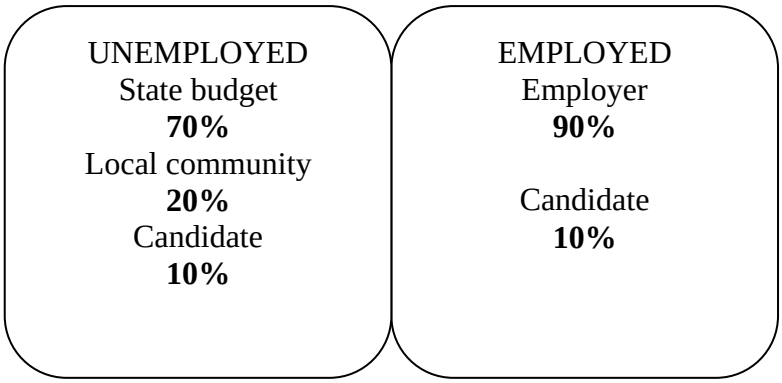


Figure 6: Proposed model of financing the validation of non-formal qualifications in relation to a candidate's work status (Petričević, 2012, p. 115)

These are legal and institutional preconditions for the development of a system of validation of qualifications, which would undoubtedly contribute to the reduction of high unemployment rates, by encouraging the youth to enter the labor market. The validation of non-formal qualifications would also improve the adult education system and enable unified evaluation criteria of all the efforts that an individual has invested in the development of his or her human capital.

4. CONCLUSION

Lifelong learning is becoming necessary for the development of a competitive individual due to global changes in the labor market, increasing flexibility, fragmentation and workforce fluctuation. At the beginning of the 21st century, the European Union highlighted the concept of lifelong learning as a social and economic priority in a number of strategic documents. The development of "knowledge society" and the human capital reinforcement are promoted by the recognition of non-formal education and the transparency of knowledge, skills and competences gained that way. By defining non-formal education mostly as a form of adult education motivating the entrepreneurial spirit of an individual, the European Union encourages Member States to develop a transparent system of validation of non-formal qualifications.

The Council of Europe has made an official recommendation to Member States that by 2018 each of them should develop a national system of non-formal qualifications matching the market needs. The latest reports show the progress has been made by most members in setting the legislative and institutional framework as a precondition for the development of a

validation system. Due to the specific socio-historical context and the process of post-socialist transition, the Republic of Croatia is still trying to catch up with the more economically developed EU countries in overcoming the gap between the education system and the labor market. Clear steps towards the validation of non-formal qualifications have become apparent with the establishment of the Croatian Qualifications Framework in 2013, which is seen as of crucial importance for the development of lifelong learning system within the Strategy of Education, Science and Technology from 2014.

Given the above, it is clear that in the past people were educated once for a lifetime through the school system. By contrast, contemporary labor market changes almost imply participation in the process of lifelong learning and thus in various forms of non-formal and informal education. There is an obvious need for a system that would, at national and EU level, recognize and classify all forms of education that an individual attended by the time of his or her first entry or re-entry into the labor market. Such a system would, besides greater security and working ability, certainly contribute to the formation of a more stable and competitive European market.

LITERATURE:

1. Adult Education Act (2007). *Zakon o obrazovanju odraslih*, NN 17/07, 107/07, 24/10. Retrieved 10.5.2017. from https://www.zakon.hr/z/384/Zakon-o-obrazovanju-odraslih
2. Bečić, M. (2014). Značaj obrazovanja na tržištu rada prema ekonomskoj teoriji. *Ekonomska misao i praksa*, 2014 (ISSN 1330-1039), 213-232.
3. Bezenšek, J. (2007). Education against/or for the Aggressive Market's Role in Post-Modern Society. *Informatologia*, 2007 (ISSN 1330-0067), 201-206.
4. Brown, P., Lauder, H., Ashton, D.(2008). Education, Globalisation and the Future of the Knowledge Economy. *European Educational Research Journal*, 2008 (ISSN 1474-9041), 131-156.
5. Cedefop, European Commission, ICF (2017). *European inventory on validation of non-formal and informal learning – 2016 update. Synthesis report.* Luxembourg: Publications Office of the European Union.
6. Colardyn, D., Bjornavold, J. (2004). Validation of Formal, Non-formal and Informal Learning: policy and practices in EU Member States. European Journal of Education, 2004 (ISSN 1465-3435), 69-89.
7. Commission of the European Communities (2000). *A Memorandum on Lifelong Learning.* Retrieved 10.5.2017. from http://pjp-eu.coe.int/documents/1017981/1668227/COM_Sec_2000_1832.pdf/f79d0e69-b8d3-48a7-9d16-1a065bfe48e5
8. Council of Europe (2003). *Recommendation Rec(2003)8 of the Committee of Ministers to member states on the promotion and recognition of non-formal education/learning of young people*. Retrieved 10.5.2017. from http://pjp-eu.coe.int/documents/1017981/3084932/COE_rec_2003_8_en.pdf/aa0c9fde-0dd0-43cf-9ca9-2df153dba296
9. Council of Europe (2017). *Non-formal learning/education*. Retrieved 10.5.2017. from http://pjp-eu.coe.int/en/web/youth-partnership/non-formal-learning?desktop=true
10. Council of European Union (2012). *Council Recommendation of 20 December 2012 on the validation of non-formal and informal learning,* 2012/C, 398/01. Retrieved 10.5.2017. from http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1387791163761&uri=CELEX:32012H1222(01)
11. Crafts Act (2013). *Zakon o obrtu,* NN 99/04. Retrieved 10.5.2017. from http://narodne-novine.nn.hr/clanci/sluzbeni/2013_12_143_3065.html
12. European Commission (2002). *The Copenhagen Declaration.* Retrieved 10.5.2017. from https://europass.cedefop.europa.eu/sites/default/files/copenhagen-en.pdf

13. European Commission (2010). *Communication from the Commission Europe 2020. A strategy for smart, sustainable and inNovclusive growth*. Retrieved 10.5.2017. from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:HR:PDF
14. European Commission (2012). *Rethinking Education:Investing in skills for better socio-economic outcomes.* Retrieved 10.5.2017. from http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0669&from=EN
15. European Commission (2013). *Flexicurity in Europe. Administrative Agreement. Final Report.* Retrieved 10.5.2017. from http://www.google.hr/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwik5Y7Ps-jTAhVGJFAKHfYcCMoQFggsMAE&url=http%3A%2F%2Fec.europa.eu%2Fsocial%2FBlobServlet%3FdocId%3D10227%26langId%3Den&usg=AFQjCNFyz7UicpZ7F5oqzgbqns8A3viIFQ
16. European Commission (2014). *European area of skills and qualifications. Special Eurobarometer 417.* Retrieved 10.5.2017. from http://ec.europa.eu/commfrontoffice/publicopinion/archives/ebs/ebs_417_en.pdf
17. European Commission, EACEA, Eurydice (2016). *Entrepreneurship Education at School in Europe*. Eurydice Report. Luxembourg: Publications Office of the European Union.
18. European Parliament, Council of European Union (2008). *Recommendation of the European Parliament and of the Council on the establishment of the European Qualifications Framework for lifelong learning.* Retrieved 10.5.2017. from http://pjp-eu.coe.int/documents/1017981/1668227/rec08_en.pdf/89b3209f-0b62-440a-99fa-c389e5bf0dd0
19. European Parliament, Council of European Union (2009). *Recommendation of the European Parliament and of the Council of 18 June 2009 on the establishment of a European Credit System for Vocational Education and Training (ECVET),* 2009/C 155/02. Retrieved 10.5.2017. from http://pjp-eu.coe.int/documents/1017981/1668227/Recommendation_establishemnt_of_a_European_credit_system_for_VET_2009.pdf/77198f4d-660e-4c24-b20a-9e2acd31100f
20. Giddens, A. (2007). *Sociologija* (2nd edition). Zagreb: Nakladni zavod Globus.
21. Gutović, T. (2016). Od tečaja do visokog obrazovanja – sport i obrazovanje odraslih. In Filozofski fakultet Sveučilišta u Splitu, *Stanje i perspektive obrazovanja odraslih u Republici Hrvatskoj* (p. 233-250). Split: Redak.
22. International Labour Office (2017). *World Employment and Social Outlook: Trends 2017.* Geneva: ILO.
23. Kitić, M., Miljak, T., Lozić, J. (2012). Cjeloživotno obrazovanje s ciljem postizanja poslovnog napretka i stvaranja financijskih vrijednosti. *Učenje za poduzetništvo,* 2012 (ISSN 1848-1264), 53-61.
24. Kuka, E. (2012). Koncept neformalnog obrazovanja. *Život i škola: časopis za teoriju i praksu odgoja i obrazovanja,* 2012 (ISSN 0044-4855), 197-203.
25. Kulić, R., Despotović, M. (2005). *Uvod u andragogiju.* Zenica: Dom štampe Zenica.
26. Lowther, J. (2003). Fleksibilnost radne snage i uloga hrvatskih socijalnih partnera u njezinu povećanju. *Financijska teorija i praksa,* 2003 (ISSN 1332-3970), 457-479.
27. Marković, D. (2005). *Šta je neformalno u neformalnom obrazovanju? Neformalno obrazovanje u Evropi.* Beograd: Grupa „Hajde da...".
28. OECD (2010a). *Recognition of Non-formal and Informal Learning Pointers for policy development.* Retrieved 10.5.2017. from http://www.oecd.org/edu/innovation-education/44870953.pdf

29. OECD (2010b). *Recognising Non-formal and Informal Learning Outcomes, Policies and Practices. Executive Summary.* Retrieved 10.5.2017. from http://www.oecd.org/edu/innovation-education/45007044.pdf
30. OECD (2017). *OECD Skills Outlook 2017. Skills and Global Value Chains. Multilingual Summaries.* Retrieved 10.5.2017. from http://www.oecd.org/edu/oecd-skills-outlook-2017-9789264273351-en.htm
31. OECD Survey of Adult Skills (2015). *Adult Education and Training*. Retrieved 10.5.2017. from https://stats.oecd.org/Index.aspx?DataSetCode=EAG_AL#
32. Perin, V. (2013). Strukovno obrazovanje i tržište rada: koncept fleksigurnosti. *Život i škola: časopis za teoriju i praksu odgoja i obrazovanja,* 2013 (ISSN 0044-4855), 147-155.
33. Petričević, D. (2012). Provjeravanje, ocjenjivanje i priznavanje kvalifikacija stečenih neformalnim i informalnim učenjem. *Andragoški glasnik: Glasilo Hrvatskog andragoškog društva,* 2012, (ISSN 1331-3134), 99-116.
34. Ratto-Nielsen, J. (2015). From non-formal to transformative learning in the EU youth programmes: unleashing the potential of entrepreneurial learning in youth work. In European Commission, *Youth work and non-formal learning in Europe's education landscape* (p. 130-150). Luxembourg: Publications Office of the European Union.
35. Relja, R., Bešker, M. (2011). Stručno obrazovanje u funkciji zapošljavanja na tržištu rada grada Splita. In Agencija za strukovno obrazovanje i obrazovanje odraslih, *Andragoška profesija i kompetencije stručnjaka u obrazovanju odraslih* (p. 276-287). Zagreb: Agencija za strukovno obrazovanje i obrazovanje odraslih.
36. Relja, R., Popović, T. (2016). Obrazovanje odraslih na radnom mjestu. In Filozofski fakultet Sveučilišta u Splitu, *Stanje i perspektive obrazovanja odraslih u Republici Hrvatskoj* (p. 219-232). Split: Redak.
37. Sundać, D., Fatur Krmpotić, I. (2009). Vrijednost ljudskog kapitala u Hrvatskoj – usporedba s odabranim europskim zemljama. *Ekonomski pregled,* 2009 (ISSN 0424-7558), 315-331.
38. Šuvar, S. (1977). *Škola i tvornica: u susret reformi odgoja i obrazovanja.* Zagreb: Školska knjiga.
39. The Croatian Parliament (2014). *Nove boje znanja. Strategija obrazovanja, znanosti i tehnologije.* Retrieved 10.5.2017. from http://narodne-novine.nn.hr/clanci/sluzbeni/2014_10_124_2364.html
40. The Croatian Qualifications Framework Act (2013). *Zakon o Hrvatskom kvalifikacijskom okviru,* NN 22/13, 41/16. Retrieved 10.5.2017. from https://www.zakon.hr/z/566/Zakon-o-Hrvatskom-kvalifikacijskom-okviru
41. Vidak, I. (2016). Pregled ključnih pojmova Hrvatskog kvalifikacijskog okvira. *Praktični menadžment: stručni časopis za teoriju i praksu menadžmenta, specijalno izdanje,* 2016 (ISSN 1847-8107), 63-65.
42. Vocational Education and Training Act (2013). Zakon o strukovnom obrazovanju, NN 30/09, 24/10, 22/13. Retrieved 10.5.2017 from https://www.zakon.hr/z/383/Zakon-o-strukovnom-obrazovanju
43. Zubović, J. (2010). *Razvoj privrede zasnovan na ulaganjima u ljudske resurse i stranim investicijama.* Beograd: Institut ekonomskih nauka.

PLAIN PACKAGING OF TOBACCO PRODUCTS: NEED OF THE HOUR

Vishal Vijayvargiya
Karanjawala & Company, India
vijayv.vishal@gmail.com

ABSTRACT

The Framework Convention on Tobacco Control (FCTC) requires nations to ratify the convention to ban all tobacco advertising and promotion. The title focuses on the repercussions of the advertisement via cigarette packages & its effect on human health with trademark infringement. The Australian Federal Government has passed the world's first Act for the Plain Packaging of tobacco Products. The Government states that peer-reviewed research shows that plain packaging of tobacco products reduces their appeal to consumer.

The Tobacco Industries argues that the plain packagings will removal the trademarks and other valuable intellectual property. The paper focuses from the effects of the new legislation introduce in Australia & the essentiatility in India. The Global Adult Tobacco Survey has held that India is the third-largest in the world in terms of tobacco use. The document recommends that India can introduce plain packaging as part of the comprehensive approach to combat tobacco use; experts say the country also needs to tighten enforcement and implementation of anti-tobacco laws. Plain packaging, particularly the Australian case study, can be an example for India.

Keywords*: Australia, India, Plain Packaging, Tobacco*

1. INTRODUCTION

Packaging differentiates the brands, particularly in homogenous products of the daily use. The tobacco specially the cigarette market has become a prominent in this respect. Marketing literature defines the critical role played by the pack design and call them the 'life blood of the firm' or the 'Silent Salesman' at times. Cigarette packaging conveys brand identity through brand logos, colour, fonts, pictures, packaging material and pack shapes. Packaging plays an important role in the sale & use of the products. It's an eye appealing for the youths since more are addicted to it at very young age in which the product design & the graphics used played a very dominant role.

Tobacco use is one of the most preventable public health threats. Tobacco products will eventually kill up to half of the people who use them – that means nearly six million people die each year. If governments do not take strong action to limit exposures to tobacco, by 2030 it could kill more than eight million people each year. The Framework Convention on Tobacco Control (FCTC) is one of the most promising developments in international control of the tobacco in the past many years. The FCTC defines tobacco advertising and promotion 'as any form of commercial communication, recommendation or action with the aim, effect or likely to effect the promotion of a tobacco product or tobacco use either directly or indirectly', and require that every ratifying country shall' undertake a comprehensive ban on all tobacco advertising, promotion & sponsorship. The World Health Organization (WHO) has long called upon countries to ban advertising and promotion of tobacco products to stem the growth of the world tobacco epidemic. Pursuant to the 2005 WHO Framework Convention on Tobacco Control (FCTC), the first treaty adopted under WHO auspices, state party to the Convention are called upon to "undertake a comprehensive ban on all tobacco advertising, promotion and sponsorship." With 174 state parties, the FCTC is one of the most widely subscribed treaties in history in the promotion of plain packaging, as more states have

moved to fulfill their legal commitments under it to ban tobacco advertising and promotion, it is comprehensively a major setback for the tobacco industries. The tobacco package with designs and graphics has rendering the most important mechanism to promote smoking amongst current and the potential smokers. With global acceleration in tobacco advertising and sponsorship bans, the pack assumes unprecedented importance as a promotional vehicle for reaching potential & current smokers. Tobacco use is the leading cause of preventable death, and is estimated to kill more than 5 million people each year worldwide. Most of these deaths are in low- and middle-income countries. The gap in deaths between low and middle income countries and high-income countries is expected to widen further over the next several decades if we do nothing. Though there is another section who thinks that the introduction of measures taken for plain packaging will just another excuse for the tax grab. Generic branding-led price reductions are likely to 'steal' tobacco profits in the form of increased revenue.

In recent years, the French courts have ruled that these novelty packs do indeed constitute advertising and are therefore illegal under French law. The Uruguay tried to draft the legislation on the same streamline which was never passed because of the outcry by the industries. The issue of tobacco control by the government is the complex one it is one of the several actual and the sustainable conflict between the intellectual property & other rights, interest and concerns that policy makers and dispute settlement entities (Courts, International Tribunals, etc) will tackle in the coming years. The analysis of the tobacco/trademark interface must be carried out carefully & thoroughly. Nowhere in the real essence of a brand more powerfully and definitely expressed than in its visual presentation. The global competition and the competitiveness in the marketability of same products at times depend on the packaging which becomes a brand image. If the packaging is plain then it would be difficult to make a differentiation between two products which would result into the probability of infringement and loss of the valuable rights own by the industry. A trademark provides their owners the legal right to prevent others from using a confusingly similar mark. Trademarks help consumers to identify and purchase a product which meets their needs because of its nature & quality indicated by its unique trademark. The major tobacco industries pleading that plain packaging would acquire their valuable brands and would infringe their intellectual property rights as there would be nil competition.

Several studies in Canada and Australia have explored the effect of consumption of tobacco products when there is plain packaging instead of regular packaging in which designs and graphics are mentioned. A survey was done amongst the young people in Canada who found the plain packages ‘uglier’ and ‘boring’ than the regular packages. Approximately one third of respondents also reported that young people of their age would be less likely to start smoking if all the tobacco products will be sold in plain packages. Though the industries are pleading that it would an infringement of their valuable intellectual property infringement which was counterfeited by the states by providing that under Article XX (b) of the General Agreement on Tariffs and Trade 1994 (GATT) and Article 8 (1) of the Trade Related Aspects on Intellectual Property Rights Agreement (TRIPS) provided the general exceptions to this universal principle that the state could take action if there is need for the protection of public health. Moreover the plain packaging is also consistent in what has been provided under the Technical Barriers to Trade (TBT) Agreement because of its limited impact on trade and its contribution to the legitimate objective of protecting public health.

2. HISTORY AND DEVELOPMENT OF PLAIN PACKAGING

In 1989, the New Zealand Department of Health’s Toxic Substances Board introduced that cigarettes be sold in white packs with simple black text & no colours or logos. During the 1989 industry legal challenge to Canadian legislation banning tobacco advertising, industry

testimony stimulated tobacco control groups to call for plain packs. Plain packaging was examined by the Canadian House of Commons Standing Committee on health in 1994. In Canada, advertising of tobacco products was prohibited by the Tobacco Products Control Act of 1988 and all tobacco products must show attributed warning signs on all packaging. Immediately following the passing of the legislation through parliament, *RJR-MacDonald (RJR-MacDonald Inc. v. Canada (Attorney General)* filed suit against the Government of Canada through the Quebec Superior Court. Recently, sin taxes have been added to tobacco products, with the objective of decreasing usage by making the products less affordable. Currently, radio ads, television commercials, event sponsoring, promotional giveaways and other types of brand advertising are prohibited as well as in-store product displays. However, certain forms of advertising are permitted, such as print advertisements in magazines with an adult readership of 85% minimum.

Until 2003, tobacco manufacturers got around this restriction by sponsoring cultural and sporting events, such as the Benson and Hedges Symphony of Fire (a fireworks display in Toronto and Vancouver), which allowed the manufacturers' names and logos to appear in advertisements sponsoring the events, and at the venues. The ban on tobacco sponsorship was a major factor that led to the near-cancellation of the Canadian Grand Prix in Montreal and the du Maurier Ltd Classic, a women's golf tournament on the LPGA tour (now known as the Canadian Women's Open).

In May 2008, retail displays of cigarettes in convenience stores in Ontario, Quebec, Newfoundland and Labrador, New Brunswick, and Nova Scotia have been outlawed. On the similar front the Uruguay government had also introduced the legislation which says that there should be health warnings on 80% of the packaging on a cigarette product. The health industries specially the Phillip Morris opposed it and declare the measures as ‘extreme’ and ‘unprecedented’. The company further argues that this restriction prevents it from effectively displaying its trademarks. On certain and similar accounts many initiative had been taken but the reforms was not made possible because of the happening of many scrupulous events.

Nevertheless the Paris Convention was introduced which provide the substantive provisions which were incorporated under the TRIPS Agreement. The Two provisions of the Convention are often mentioned in relation to plain packaging for tobacco products, namely Articles 6quinquies A & B and Article 7. There are three reasons to explore two conventions possible application to plain packaging:

a) First, Article 7 of the Convention (Which is reflected in TRIPS Article 15.4) contains a right to register a trademark independently of the nature of the goods to which it is applied. This is an indicator that the spirits of the Paris Convention is to permit the use of marks.
b) Second, proponents of Plain Packaging have suggested that Article 6quinquies (which states that trademarks may be denied registration or invalidated when the mark is “contrary to morality or public order and in particular, of such nature as to deceive the public) could be used as a basis for implementing plain packaging.
c) Third, it has been suggested by proponents of plain packaging that these Articles of the Paris Convention are evidence that there is no right to use a trademark.

And finally the Framework Convention on Tobacco Control (FCTC) was introduced which urge for the comprehensive ban on the tobacco advertisement and promotion. The WHO call the member states to ratify the framework so that the epidemic related with the addiction of the tobacco usages among the people specially the young ones could be controlled. The WHO FCTC demonstrates continued global commitment to decisive action against the

global tobacco epidemic, which kills millions of people and costs hundreds of billions of dollars each year.

A total of 173 Parties to the WHO FCTC, covering about 87% of the world's population, have made a legally binding commitment to implement effective tobacco control policies. The WHO FCTC provides countries with the necessary tobacco control tools that, when implemented and enforced, will reduce tobacco use and save lives. Hence the Australian government on the similar grounds has made the first such Act that all the cigarette packages should be sold on plain packaging.

3. INTRODUCTION AND DEVELOPMENT OF TOBACCO PLAIN PACKAGING BILL INTO ACT 2011, AUSTRALIA

In 1945, 72% of Australian men were smokers – if nearly everybody around you is smoking, then taking up smoking is difficult to resist. Then, the Robert Menzies' government introduced a voluntary tobacco advertising code for television in 1966, and the Fraser government introduced legislation that banned cigarette advertising in 1976. In Australia in 1992 the centre for Behavioural Research in cancer recommended that regulations be extend to cover the colours, design and wording of the entire exterior of the pack. The Tobacco Advertising Prohibition Act 1992 expressly prohibited almost all forms of Tobacco advertising in Australia, including the sponsorship of sporting or other cultural events by cigarette brands. Domestic sporting and cultural events were allowed to have sponsorships run their course, but were no longer allowed to enter into new or renew existing sponsorships. By 1998, all domestic sponsorships had expired naturally.

The reason why only 2.5 per cent of children in Australia in the 12-17 age group smoke daily is not difficult to figure out they have never been exposed to any cigarette advertising. If the Australian government banned cigarette advertising on television and radio way back in 1976, a similar ban for the print media came into effect in 1989. Pictorial warning was enforced in 2006, and since 2010 tobacco products have been removed from sight in retail outlets. Now the Plain Packaging Bill 2011 legislated recently seeks to undermine the last powerful marketing vehicle used by manufacturers to build and sustain brand image — cigarette packaging. With effect from December 1, 2012, cigarette packs and tobacco products will have no logos, promotional text, or colour variation. Instead, 75 per cent of the pack must carry horrendous pictures of diseases and conditions caused by smoking. Large text warnings must accompany the pictures. The rest of the pack will have a plain background with the name of the company and cigarette brand in a prescribed size and font. In short, packaging will be used for strongly conveying a vital public health message, and for reducing the association with the brand's identity. Unsurprisingly, the revolutionary legislation has been challenged by one of the manufacturers — Philip Morris Asia of Hong Kong that owns the Australian affiliate.

The challenge is mainly on the ground that the government has been "unable to demonstrate" that plain packaging will be "effective in reducing smoking." There is no precedent to measure the effectiveness of plain packaging. But the fact that adult smoking rates dropped from 24 per cent in 1991 to 15 per cent in 2010 is proof that several marketing and smoking restrictions put in place have produced excellent results. In fact, as a signatory to the WHO Framework Convention on Tobacco Control (FCTC), Australia is following the world health body's guidelines on plain packaging.

In April 2010, the Australian government announced plans to prohibit the use of tobacco industry logos, colours, brand imagery or promotional text of tobacco product packaging from 2012, requiring that brand names and product names be displayed in a standard colour, font style and position in a policy known as "plain packaging".

The government followed the recommendation made by the Preventive Health Taskforce which was set up by the government to review the effects of plain packaging on smokers which give the principle that by introducing plain packaging on cigarette products the proportion of Australians who do daily smoking would reduce by 10% by 2018.

The Research shows that plain packaging will:

- Increase the noticeability, recall and impact of health warning messages
- Reduce the ability of packaging to mislead consumers to believe that some products may be less harmful than others
- Reduce the attractiveness of the tobacco product, for both adults and children.

The Government states that 15,000 Australians die annually from tobacco related illness and the cost to the health system and economy resulting from smoking is AUD$31.5 billion. The Government also states that peer-reviewed research shows that plain packaging of tobacco products reduces their appeal to consumers, including the young, increases the effectiveness of mandatory health warnings and reduces the likelihood that the packaging will mislead consumers to think that some cigarettes are less harmful than others.

The Act contains the following essentials:

1. Subject to the regulations, cigarette packaging must be coloured drab-dark brown, apart from the brand, business name, company name or variant name for the products (‘Name') (which must be in prescribed size, colour, position, style and typeface) and health warnings or other legislative requirements.
2. Other than the Name, health warnings and other legislative requirements, trademarks must not be used on cigarette packaging or the cigarettes. This is to prevent their use as design features or to detract from health warnings;
3. A Name must only appear once on the front, top and bottom outer surfaces of a cigarette packet; and bottom outer surfaces of a cigarette packet; and
4. Breach of the plain packaging provisions by way of, among other things, sale, supply, manufacture, packaging and/or purchase (other than by an individual for personal use) of non-compliant cigarette products attracts criminal liability. Fines of up to $220,000.00, for an individual and $AUD1.1 million, for a corporation apply for fault-based criminal offences and breaches of civil penalty provisions.

Cigarettes are toxic and poisonous, containing more than 4,000 chemicals. An estimated 15,000 Australians die every year from tobacco related diseases. Tobacco consumption remains one of the leading causes of preventable death and disease in Australia. In 2010, approximately 3.3 million Australians still smoked, which is equivalent to about 15.1% of Australians aged 14 years and over. This is down from 30.5% in 1988. The social and economic costs of smoking in Australia are estimated to be $31.5 billion annually. Indigenous smoking rates remain high. Approximately 47% of adult Indigenous Australians smoke. Smoking causes about 20% of Indigenous deaths.

The WTO Council meeting on the Trade-Related Aspects of Intellectual Property Rights (TRIPS Council) on 7 June 2011 has made the picturesque clear when the Dominican Republic objected the Australia‘s plain packaging scheme on the basis that it would be inconsistent with Australia‘s obligations under the TRIPS Agreement. Supporting the Dominican Republic‘s stance were other WTO members: Honduras, Nicaragua, Ukraine, the Philippines, Zambia, Mexico, Cuba and Ecuador. In contrast, New Zealand, Uruguay and Norway supported Australia‘s draft law, while India referred to studies showing the effectiveness of plain packaging in reducing smoking. India, Brazil and Cuba all emphasised

the right of members to implement public health policies, as noted in the Doha Declaration on TRIPS and Public Health. The WHO also made a statement in its role as an observer in the TRIPS Council. Having regarded to these factors together with the recommendation of the World Health Organisation, on 6 July 2011 the Government introduced the Tobacco Plain Packaging Bill 2011 (Tobacco Bill) which was subsequently passed and became an Act on 1st December 2011.

3.1 Role & Contentions of Developing Nations

The Australian Act intended to make cigarette packaging less appealing to consumers and decrease tobacco consumption has once more met opposition at the WTO with a number of tobacco-producing developing countries, citing competitiveness concerns. The Australian government announced that cigarette companies will be given additional time to comply with the public health measure, due to repeated delays in moving the legislation through Parliament. The Australian Act provides that all cigarettes sold in Australia be packaged with one colour and shape only, and that a significant portion of the front and back packaging be used for health warnings.

Some developing country tobacco producers - such as Nigeria, the Dominican Republic, Honduras, and Cuba - say such a law would curtail competitiveness in the cigarette market and may not effectively address intended public health objectives.

They echo a sentiment also expressed by big tobacco companies, particularly Philip Morris International. During the TRIPS Council discussions, the developing countries likely to be affected by such legislation argued that the proposed bill might reduce prices and the trafficking would increase which could even incite the illicit consumption.

According to the Dominican Republic, competing products would not be able to be differentiated from one another should such legislation enter into force. They also argued that the plain packaging requirement would likely reduce cigarette prices, since competition by use of trademark would be restricted. Cigarette quality would drop, they added, potentially paving the way for an illicit market. The Dominican Republic - which noted that tobacco represents 10 percent of its agricultural production - also suggested that the plain packaging requirement could be inconsistent with Australia's obligations under TRIPS Article 20 on special requirements and Article 10bis of the Paris Convention for the Protection of Intellectual Property.

Article 20 of the TRIPS Agreement forbids trademark usage from being "unjustifiably" held back by special requirements, which pertain to "use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings."

4. INDIA AND PLAIN PACKAGING ON TOBACCO PRODUCTS

According to the Global Adult Tobacco Survey 2009-2010, India has nearly 274.9 million tobacco users, which are more than the total population of many countries; it is the third largest in the world in terms of tobacco consumption. Nearly one million people are killed every year due to tobacco related diseases. It is argued that there is a strong need to bring legislation in India related with the plain packaging. India has a unique position in tobacco control as it is the second largest producer and consumer of tobacco products in the world. The huge burden of tobacco use in India, aggressive marketing of tobacco products which are targeting the youth, and the delay in the introduction of large and strong pictorial health warnings merit advocacy for the introduction of plain packaging measures in India as well. Plain Packaging will increase the noticeability, recall and impact of health warning messages, reduce the ability of packaging to mislead the consumers to believe that some

products may be less harmful than others and reduce the attractiveness of the tobacco products for both adults and the young.

More than one million people die every year in India due to tobacco consumption & according to the Tobacco Atlas (citing the Planning Commission's data) US$ 6.32 billion is spent on the annual health care costs due to just three tobacco related diseases (cancer, coronary artery disease, and chronic obstructive lung disease). Compared to this the government annually collects only $ 1.62 billion in revenues, largely from the taxation of cigarettes. The government could plead that it has the legal right to enforce the plain packaging on the tobacco products when it comes to the issues related with the protection of the health of its citizens as per the norms provided under the WTO. India ratified the WHO convention in 2004; it was the eighth and largest country to do so. There is a clear need to strengthen the national initiatives undertaken since then, considering that an estimated 35 per cent of adults use some form of tobacco today. The Union Health Ministry's latest move after putting pictorial health warnings on tobacco products to cut down on tobacco use is plain packaging, the union health ministry plans to push for plain packaging. There is a large variety of products and ways of using tobacco for smokeless use. The chewing tobacco products with flavour include zarda and scented khaini, which are industrially manufactured and available in India, Bangladesh and Myanmar. India plays a constructive role in the FCTC negotiations, supporting a strong and tough treaty to incorporate effective evidence on tobacco control measures for reducing the demand and supply of tobacco. Under the FCTC rules India has adopted the strong tobacco regulations though the contribution in the economic development in terms of taxes and other revenue collection it seems that the industries would have put a hindrance in making the implementation possible on effective way. Though if there is an implementation tha it would not only prohibit the use of plain package on the tobacco products but also ban on the advertisement or using any parallel strategies. The situation in India related with the tobacco consumption in youths has been tremendously increasing who are between the ages of 15 – 20 years. Studies in India revealed that tobacco consumption among starts from Grade VI which is a sign that the consumption will increase in the coming years and if no proper efforts has been taken than it will result in developing the disease like incurable oral cancers and other deadly diseases.

In India the development of the tobacco industries has been rapidly increased in the past few years. The reason for the development is the low income and poverty. The stringent measures are essential in India because of the high mortality rate by consuming it. More than half of the deaths related with the tobacco smoking are caushed among the illiterate sub population and roughly 80% of deaths are in rural areas. The data produce by the planning commission made it clear that every year the government invested approximately $1.195 billion on health care issues related with the tobacco consumption whereas the revenue generated by them is around $1.62 billion. Because the bidi industry is fragmented there are no specific figures which show that how many bidis are sold or produced. According to the Report of Public Health Foundation of India, the bidi industry in India is worth of USD $ 4.1.billion which is a powerful lobby in the Indian politics which plays an important role in the taxation and other policy framework.

One of the landmarks Act related with the tobacco control in India is 'Cigarettes and Other Tobacco Products (Prohibition of Advertisement and Regulation of Trade and Commerce, Production, Supply and Distribution) Act, 2003 (COTPA)' the effective measures has been taken by the PHFI by introducing a similar taskforce with the Australian on introducing the same benchmark by introducing the amendment in the set COTPA which would be an effective tool to introduce the plain packaging in India.

Ten percent of the world's tobacco smokers live in India, and the Indians are the second largest group of smokers after china. India is also the second largest producer and consumer

tobacco products in the world, the government has taken the initiative by introducing the COTPA and was a key driver in the WHO's FCTC. India also introduces the National Tobacco control Programme for the further strengthen measures to control the mechanism. The state should create a strong bond between the FCTC and the introduction of the legislation. It is essential that the legal methods should be understood in consonance of the health measures and both should be carried on hand to hand basis. The introduction of plain packaging in India will not solve the purpose alone but it is essential that it should deal with the India's condition and situation. In India still the major hindrance is the product standardisation which has to get resolved before introducing any such methodology. Indian market is different from the developed countries market and just following the path which the developed nations have used would not be a part of intelligence. Another need before the introduction of plain packaging in India is the imposition of hard tax regimes as to make less affordable to a certain class of people. It is evident from the facts that the major consumers of tobacco products are either the young or the people living in rural areas, hence the strong tax will hold the key to put less comfort to these sections.

The plain packaging is an important effort towards the transformation of society, the state could use the increase in pictorial graphics which could eventually lead to plain packaging (like in Australia), while the other could be direct push towards the standardisation of all packs across all the products so as to make less reachable and the last is any sort of promotion via advertisement and other ways to promote it.

5. CONCLUSION

In 2007, the BBC ran a Poll asking: will graphic images on tobacco products stop you smoking? 36.3% of the 12,500 respondents say 'yes'. When the policy was later introduced, however, it had no observable effect on the smoking rate.

Various international trade agreements protect trademarks & other intellectual property, including the TRIPS agreement, the NAFTA, & the Paris Convention for the protection of Industrial Property. All of these treaties allow exemptions if a benefit to public health is likely to occur but, as we have seen, there is little reason to believe that any such benefit will result from plain packaging. This is why Canadian government rejected the rate, and therefore improve health policy, the Canadian concluded that plain packaging would breach international trade agreements & ditched it.

Though the latest report shows that Australia's government may have to delay plans for the world's toughest anti-tobacco laws after conservative opposition lawmakers on Wednesday postponed a final vote on the controversial legislation in parliament. The new laws, which will force cigarettes to be sold in plain packaging from 2012, are being closely watched by New Zealand, Canada, the European Union and Britain, which are considering similar restrictions. Australia says the new laws reflect its obligations under the World Health Organization's 2005 framework against tobacco, which urges states to consider plain packaging laws. The WHO estimates more than 1 billion around the world are regular smokers, with 80 percent in low and middle income countries.

The laws have angered tobacco producers who have threatened a High Court challenge, while the governments of Nicaragua and Ukraine said the new measures breached international trade rules and would be challenged in the World Trade Organization. Analysts say tobacco companies like Britain's Imperial Tobacco and Philip Morris are worried that plain packaging could spread to emerging markets like Brazil, Russia and Indonesia, and threaten growth there.

The consumption of tobacco products in India is very much depend on the socio economic factors, the people who have no education or having less education have 2.69 more times

more likely to smoke and chew tobacco than those with having proper education or are educated. Plain packaging will definitely help in bridging the gap by reducing the impact of external packaging and highlights the dangers of tobacco consumption by amplifying the pictorial warnings.

LITERATURE:

1. REPORTS:

1. WHO expert Group Meeting (2012), *Smokeless tobacco control and cessation*, Delhi.

2. International Union against Tuberculosis and Lung Disease, (2012), *Plain Packaging of Tobacco Products*, Public Health Foundation of India, Report of the Australia India Institute, Taskforce on Tobacco Control.

2. WEBSITES:

1. LeGuay Peter and Chant Catherine, *Tobacco Plain Packaging Bill: Health Policy: Intellectual Property Rights* retrieved on 11.04.2013 from www.gala-marketlaw.com.

2. WHO Report on the *Global Tobacco Epidemic 'Implementing smoke free Environment*, retrieved on 25.01.2013 from www.who.com.

3. Projects and Programmers, *Enforce bans on Tobacco Advertising, Promotion and Sponsorship*, retrieved on 19.01.2013 from www.who.com.

4. Dr. Alwan Ala (2009), *WHO Report on the global tobacco Epidemic*, retrieved on 21.04.2013 from www.who.com.

5. Harrison Paul *Plain Cigarette Packaging will change smoking…slowly* retrieved on 19.07.2013 from www.theconversation.edu.au.

6. The Health and Social care Information Centre (2011) *Statistics on Smoking*, England, retrieved on 05.07.2013 from www.icnhs.uk.

7. Taylor Allyn *Plain Packaging: Fighting the chill of International Treaties*, retrieved on 17.07.2013 from www.jurist.org.

8. ASH Action *Plain Packaging of Tobacco*, retrieved on 23.07.2013 from www.ashaust.org.au.

9. Ministry of Health and Family Welfare, Government of India *Global Tobacco Survey GATS India 2009-2010*, retrieved on 05.07.2013 from www.searo.who.int.

10. Hammond David, *Tobacco labeling and packaging toolkit: A guide to FCTC Article 11* retrieved on 23.07.2013 from www.tobaccofreeunion.org.

11. Freeman Becky, Chapman Simon & Rimmer Matthew, *The case for the Plain Packaging of tobacco product*, retrieved on 15.07.2013 from www.ncbi.nlm.nih.gov.

Gervais Daniel (2010), *Analysis of the Compatibility of certain Tobacco Product Packaging rules with the TRIPS Agreement and the Paris Convention*, retrieved on 15.07.2013 from www.jti.org.

13. Mutume Gumisai, *Health and Intellectual Property 'Poor nations and drug firms tussle over WTO patent provisions*. retrieved on 15.07.2013 from www.un.org.

14. Parr Victoria, Tan Benita, Ell Patrick and Miller Kylie, (2011), *Report on Market Research to determine effective plain packaging of tobacco products, Department of Health*, retrieved on 19.07.2013 from www.health.gov.au.

15. Underwood R. L. Ozanne J. *Is your package an effective communicator? A normative framework for increasing the communicative competence of packaging* retrieved on 25.07.2013 from www.marketing.pamplin.vt.edu.

16. Hammand R. Assunta M., *Promising Start Uncertain Future, Tob Control,* The Framework Convention on Tobacco Control retrieved on 25.07.2013 from www.tobaccocontrol.bmj.com.

17. Davidson Mark *Big Tobacco v. Australia: Phillip Morris Scores an Own Goal*, retrieved on 23.07.2016 from www.pc.gov.au.

18. WHO Report on the *Global Tobacco Epidemic, Implementing smoke free Environment,* retrieved on 19.04.2013 from www.who.com.

19. Center for Behavioural Research in cancer, *Health Warnings and contents labelling on tobacco products,* retrieved on 06.08.2013 from www.tobaccocontrol.bmj.com.

CASH PRINCIPLE OF DETERMINING THE TAX IN CROATIA

Vlasta Roska
University North, Koprivnica, Croatia
University Centre Varaždin
vlasta@vlastaroska.hr

ABSTRACT

Since Croatia joined the EU in 2013, the first tax topic was the abolition of payment of value added tax on cash basis for taxpayers on income. The abolition of VAT payment under the cash basis was justify of alignment with the EU Directives and EU requirements. However, from 1.1.2015. when this privilege should be abolished, instead of abolishing, cash principle has spread to the taxpayers on the corporate income tax. Since 2015, all taxpayers with a turnover up to HRK 3,000,000.00 can choose the payment of value added tax according to cash basis and since 2017, all taxpayer can choose the payment of corporate income tax according to the cash basis. The main aim of this paper is to examine how the taxpayers choose the payments model of VAT and CIT and whether they use the advantage of the cash basis model due to general lack of liquidity. The working hypothesis has set to confirm the aim of this paper: the complexity of obtaining data needed for the tax model according to cash-basis are the main obstacle to the use of the cash model of a bigger number of taxpayers. The working hypothesis is confirmed.

Keywords*: accrual basis, cash basis, corporate income tax, value added tax*

1. INTRODUCTION

In Croatia, about 98% are small and micro companies. Small and micro companies is very important segment of business for all aspect of society. The most companies are still facing problems with the collection of receivables and uncertain invoice collection periods. The statutory payment periods are 30 or 60 days, but due to general insolvency for the most of taxpayer is impossible to reach. They cannot dictate market condition, because of their size and for this reason government need to find the way to help and protect them. Some of the latest measures have been presented in the latest tax reform last year. Since 2013, Croatia adopted all EU Directive and requirements. All EU requirements have implemented in Croatian laws. The common tax policy in EU is primarily related to indirect taxes that directly affect the functioning of the common market in the area of free movement of goods and freedom of service, like us Value Added Tax (in further text - VAT). On the beginning, the first topic was the abolition of VAT payment on cash basis for all taxpayers on income. The abolition of VAT payment under the cash basis was justify of alignment with the EU Directives and EU requirements. However, from 1.1.2015. when this privilege should be abolished, instead of abolishing, VAT cash principle has spread to the taxpayers on the profit. Since 2015, all taxpayers with a turnover up to HRK 3,000,000.00 can choose the payment of VAT according to cash basis. Due to the increasing insolvency of entrepreneurs and the inability to collect its receivables, calculation and payments of corporate income tax (in further text – CIT) on the cash basis has introduced from January 1, 2017 in Croatia.

2. LEGAL FRAMEWORK OF TAXES

In this part is explained the Croatian legal framework for VAT and CIT, as well as in EU. CIT taxpayers maintain their accounting books according to the accounting standards, Croatian or International. Accounting standards prescribed bookkeeping according to the accrual basis as well as the preparation of financial statements, except cash flow statements. The accrual basis requires companies to report income and expenses as they are incurred, no

matter when they receive the money. In Croatia, for all CIT taxpayer double-entry bookkeeping on the accrual method is compulsory. Thant means, all books are according to the accrual basis, but CIT taxpayers have to opportunity to use cash basis for VAT payments or for CIT payments, if they satisfied prescribed conditions.

2.1.VAT according to cash basis in Croatia

Croatia have started with VAT system in 1988. At this time, VAT payments according to collection of claims was available only to the person subject to personal income tax (craftsmen, self-employed persons and citizens – registered for VAT). After January 1, 2015, all micro or small entrepreneurs, taxpayers who have threshold based on their annual turnover to the HRK 3,000,000.00 can choose between two systems, normal, old VAT payment method according to the issued invoiced and second new cash method according to collection of claims. Cash basis for micro and small entrepreneurs means, that they pay VAT on the differences collected outgoing VAT and paid incoming VAT. These taxpayers need to provide the information's of date of payment for all outgoing and incoming invoices. This method does not apply to delivers and acquisition goods within the EU Member States, services rendered for a taxpayer for which the VAT is payable by the recipient (reverse charge mechanism), export, import, as well as some special procedure prescribed by VAT (Article 125j. VAT Law, 2016). If entrepreneurs decide of payments of VAT according to the cash basis, that needs to give written declaration to the tax authority to the end of the year for next year. In this case, taxpayer needs to stay in this system minimum 3 years. The taxpayer needs to put on his invoices remark: VAT payment according to the collected claims - Article 125i. VAT Act. In the VAT Act (Article 196d.) is also prescribed when is VAT occurs according to the cash basis by determined time of payment in case of remittance in favour of a giro account, the moment of receipt of cheque, or received or transfer of bills of exchange and so on. All above mentions are very important information's for VAT payments on cash basis which taxpayer need to provide in their accounting books.

2.2.VAT according to cash basis in EU

In EU member SMEs is very important and their contribution to economic development has been recognized in the EU. The Council Directive allow the implementation of the VAT payments according to the cash basis. The provisions of Article 66 introduce a possibility of VAT assessment based on collected consideration in the part relating to output VAT, whereas Article 167a. regulates the time of deduction of input VAT. A total of 22 EU Member States (Osmanović, 2016. p.5), Austria, Belgium, Bulgaria, Estonia, Greece, Croatia, Italy, Ireland, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, Germany, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and United Kingdom implement the cash basis scheme for VAT with different VAT registration requirements. In Belgium, this principle applies only to suppliers of physical persons who do not issue invoices and suppliers of state administration bodies. In Lithuania, it applies only to farmers. Member States applying this accounting scheme set a threshold (Kuliš, 2014, p.2) for taxable persons based on their annual turnover that may not exceed EUR 500,000 or the equivalent in national currency. After consulting the VAT Committee, Member States may raise the threshold to a maximum of EUR 2,000,000 or the equivalent in national currency. However, such consultation with the VAT Committee is not required for Member States which applied a threshold higher than EUR 500,000 or the equivalent in national currency on 31 December 2012. In most of the countries, a primary requirement is the threshold level, which ranges from EUR 25,000 in Cyprus, 45,000 in Poland to EUR 2,000,000 in Ireland, Spain, Ireland, Italy and Malta (Kuliš, 2014, p2; Osmanović, 2016. p.5).

2.3.Corporate income tax

Companies pay CIT according to tax base determinate pursuant of the accounting regulations as the difference between revenues and expenditures before the corporate income tax assessment, increased and reduced in accordance with provisions of the Corporate Income Tax Act. From, 2017, some of companies can choose to pay CIT according to cash basis.

2.3.1. Corporate income tax according to cash basis in Croatia

Croatia's CIT tax rate was reduced to 18 % or 12 % on January 1st, 2017, from 20 % 2016. For taxpayers with revenues in the tax period lower than 3 million Croatian Kuna, the rate of 12% is applied. From 2017, CIT taxpayers can choose between the CIT payment method according to the accrual basis and CIT payments method according to cash basis. The CIT base is the accounting profit, increased and reduced in accordance with provisions of the Profit Tax Act. Croatian residents pay CIT on profit derived in Croatia and abroad, and non-residents (e.g. branches) pay CIT only on profits derived in Croatia. The tax base also includes gains arising from liquidation, sale, change of legal form, and division of the taxpayer where it is determined at the market rates. Taxpayers can to use cash basis if have revenue to the HRK 3 million and if they are VAT registered on cash basis also.
Before 2017, the cash basis has been linked only to tradesmen and freelancers who pay the income tax and now is introducing this principle into the CIT system. The accrual model and cash model start from profit or loss from Profit or Loss Statement. The cash model before increasing or decreasing the tax base, ask some adjustment from accrual basis to the cash basis. The tax base shall be increased or decreased for total non-cash transactions and unrealized gains / losses and certain cash transactions and realized gains / losses arising in the taxable period. Taxpayers who determine the tax base according to the cash principle submit annual tax returns in accordance on the PD-NN form.
The CIT base is reduced by the following items:

- Income from dividends and profit sharing (i.e. dividends and shares in capital that are paid by the company that pays CIT that is identical to Croatian CIT, which has a prescribed legal form, and dividends and shares in capital that the payer didn’t use as recognised cost [i.e. deduction] in one’s CIT return).

- Unrealised gains from value adjustments of shares (increase of financial asset value) if they were included as income in the profit and loss (P&L) account and offset previously recognised tax non-deductible unrealised losses from the same financial year.

- Income from collected written-off claims that were included in the tax base in the previous tax periods but not excluded from the tax base as recognised expenditure.
- The amount of depreciation not recognised in previous tax periods, up to the amount prescribed by the CIT Act.
- The amount of tax relief or tax exemption in line with special regulations (i.e. costs of education, costs of research and development (R&D), and costs of a new employee’s salary).

The CIT base is increased by the following items:

- Unrealised losses from value adjustments of shares (decrease of financial asset value) if they were included as expenses in the P&L account and do not offset previously recognised gains from value adjustments from the same financial asset.

- The amount of depreciation in excess of the amounts prescribed by the CIT Act.
- 50% of entertainment costs (food and drink, gifts with or without the printed firm logo or product brand, and expenses for vacation, sport, recreation, renting cars, vessels, airplanes, and holiday cottages). Entertainment costs do not include the costs of goods and merchandise adapted by a taxpayer for business entertainment purposes, labelled 'not for sale', and other promotional objects with the name of the firm or merchandise or other advertising objects (e.g. glasses, ashtrays, table cloths, mats, pencils, business diaries, cigarette lighters, tags) put to use in the selling area of the purchaser and given to consumers, provided that their value does not exceed HRK 160 per item.
- 30% of the costs, except insurance and interest costs, incurred in connection with owned or rented motor vehicles or other means of personal transportation (e.g. personal car, vessel, helicopter, airplane) used by managerial, supervisory, and other employees, provided that the use of means of personal transportation is not defined as salary. The percentage of 50% non-deductible expenses incurred in relation to personal cars will be applicable as of 1 January 2018.
- Asset shortages exceeding the amount prescribed by the Croatian Chamber of Economy or Croatian Chamber of Trades and Crafts, in accordance with the Value-added Tax (VAT) Act and on the basis of which no PIT was paid.
- The costs of forced collection of taxes and other levies.
- Fines imposed by competent bodies.
- Late payment interest charged between associated persons.
- Privileges and other economic benefits granted to natural or legal persons for the purpose of causing or preventing a certain event in favour of the company (generally related to commissions paid to parties acting on behalf of the taxpayer).
- Donations in excess of the amounts prescribed by the CIT Act.
- Expenditures identified during tax authority's audit, including VAT and contributions related to hidden profit payments and withdrawals from shareholders, company members, and physical persons performing independent activities taxable by CIT.
- Any other expenditure not directly related to profit earning, as well as other increases in the tax base, which were not included in the tax base.

2.3.2. Corporate Income Tax in EU

In the European Union, the area of direct taxes, i.e. income tax and CIT, is still largely within the national sphere. The European Union rarely deals with the taxation of an individual's income, and then seeks to ensure equality in terms of the opportunity to work or invest in another Member State. In the field of taxation of EU companies, the EU has two objectives: (1) to prevent harmful tax competition from member states and (2) to allow free movement of capital. CIT on cash basis is in internal regulation of each EU county and is implement only for some specific type of legal form or activities or size. The main point of CIT tax on cash basis is to help micro or small companies or individuals. Does not exist any research for CIT cash basis model in EU. All information about the CIT cash basis in EU is collected by Author from different tax web page or from answer of tax advisers.

In EU, the most country use the cash basis for payment of tax only for self-employed person, crafts, traders or some companies who do not need to have bookkeeping according to the

special laws or some limits of turnover for companies (Austria, UK, Czech Republic, Germany…). The most countries use the cash basis for income tax, not for corporate income tax. In UK taxpayers can start to use cash basis if they are VAT registered as long as their income is £150,000 or less during the tax year. Cash basis' is a way to work out taxpayer's income and expenses if they are a sole trader or partner. They can stay in the cash scheme up to a total business turnover of £300,000 per year. Above that, they'll need to use traditional accounting for next tax return. Limited companies and limited liability partnerships can't use cash basis. There are also some specific types of businesses that can't use the cash scheme.
In Austria, the general principles for determining industrial, commercial, and professional profits are the same for individuals and corporate entities. Taxable profit is the total income realized from carrying on business activities, whatever the nature of the income or business. As a general rule, the taxable profit of a small business (up to a turnover of EUR 700,000) and special freelance professionals (e.g. lawyers, tax advisors, artists, doctors) is calculated on a cash basis. For a larger business, the profit is calculated on an accrual basis of accounting.
In Czech Republic, taxable income is computed in one of two ways. For businesses registered in the Commercial Register or having an annual turnover exceeding CZK 25 million, double-entry bookkeeping on the accrual method is compulsory. Such individuals compute their income and deductible expenses under the same rules that apply to companies. In other cases, income and expenditure are computed on a cash basis. Taxpayers operating on the cash basis may choose between deducting actual allowable expenditure or claiming a standard, lump-sum deduction. In the Czech Republic, only taxpayers who does not have obligation to keep books can be taxed based on cash principle. Those are mostly individuals (subject to personal income tax). Exceptionally this rule can cover permanent establishments (foreign taxpayers not having branch from the legal point of view).
Small and medium enterprises in Germany can account of VAT on a cash basis. Where applicable, VAT will only be paid to the tax authorities when collected from the customer. The condition is that the taxable turnover in the previous year does not exceed €500,000. Also, certain taxpayers such as self-employed individuals and companies with no bookkeeping obligations can benefit from the cash accounting scheme. A separate application must be filed and the authorities should approve the request before this scheme is implemented.
In Poland, according to the answer of tax adviser they do not have the option in their laws for CIT taxpayers to pay the CIT according to the cash principle.
In Slovenia, the payment of CIT of legal entities according to the collected realization (cash basis) is not possible. The principle of cash basis applies only to persons with public rights.

3. THE GOALS, BASIS, AND HYPOTHESIS OF THE RESEARCH

The main aim of this paper is to examine how the taxpayers choose the VAT and CIT payments model and whether they use the advantage of the cash basis model due to general lack of liquidity. The research described in this paper is based on information obtained from the questionnaire to the accountant and directors of small and micro entrepreneurs. The questionnaire was send to 2.000 companies and 605 or 30.25% replay on them.
For the statistical analysis, this paper uses analysis stemming from chi-square tests and correlation coefficients to examine interdependencies. The statistical study used the software package SPSS 21.
Working hypothesis:
H = The complexity of obtaining data needed for the tax model according to cash-basis are the main obstacle to the use of the cash model of a bigger number of taxpayers.

To test the working hypothesis, the following statistical hypothesis were used:
H1 = There is a statistically significant association between the VAT payments model and complexity of using the cash basis for the VAT taxpayer
H2 = There is a statistically significant association between the CIT payments model and complexity of using the cash basis for the CIT taxpayer
H3 =There is statistically significant correlations between size, activities and tax models
H4 = There is statistically significant correlations between tax models and characteristics of cash basis model (complexity of the form, source of information and benefits)

4. RESULTS OF RESEARCH

In Croatia are 226.027 active entrepreneurs such as trade companies, co-operatives, Institutions, bodies, associations and organisations, entities in crafts, trades and free lances) (Croatian Bureau of Statistics, 2017). From the total numbers, 52,38% are trade companies and 34% are entities in crafts, trades and free lances. From all trade companies about 98 % are micro and small companies.
Total respond on questionnaire was 605 micro and small companies. Micro companies are companies which not pass two of three criteria: total assets HRK 2,600,000, total revenue HRK 5,200,00 and no more than 10 employees (Accounting Act (2016), Article 5. p.2.). Small companies are companies which are not micro and not pass two of three criteria: total assets HRK 30,000,000, total revenue HRK 60,000,00 and no more than 50 employees Accounting Act (2016), Article 5. p.3.).
From the total numbers of answer 89,26% companies paid CIT according to accrual basis, and only 10,74 report for first time payment of CIT on cash basis like as show on Figure 1. For the VAT situation is little better 67,93% paid VAT according to the issued invoices (accrual accounting) and 32,07 % on collected invoices (cash basis). The better situation in using the cash basis of VAT is that we use that method from 2015., and VAT books is not so complicated.

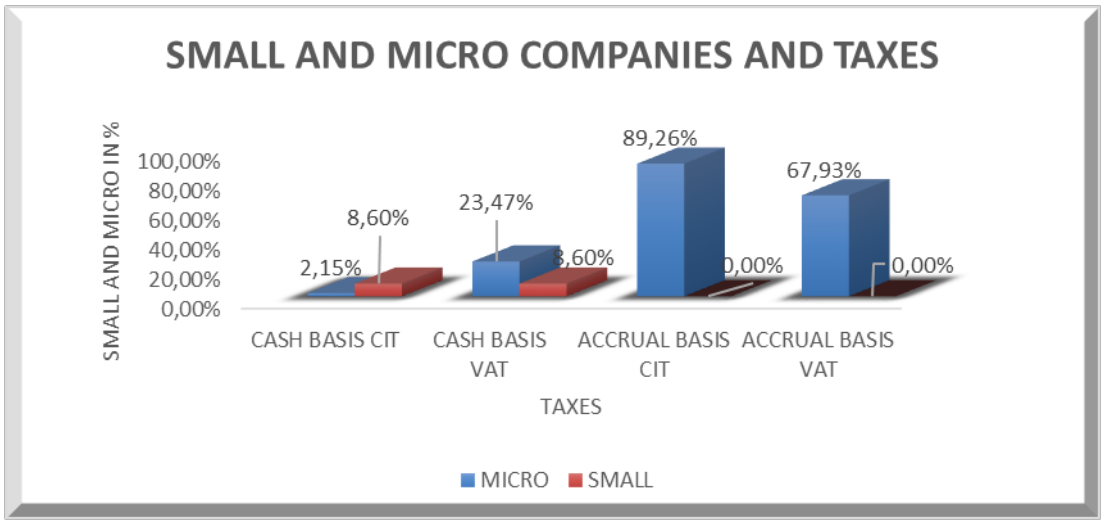


Figure 1: Small and Micro Companies and Taxes (Author)

Cash basis for VAT payment use 52.10% of trade companies, 23.20% restaurants and cafes activities and 22.70% from production like us shown in the Figure 2. Cash basis for CIT payment use 67.70% production companies and 32.30% of trade activities.

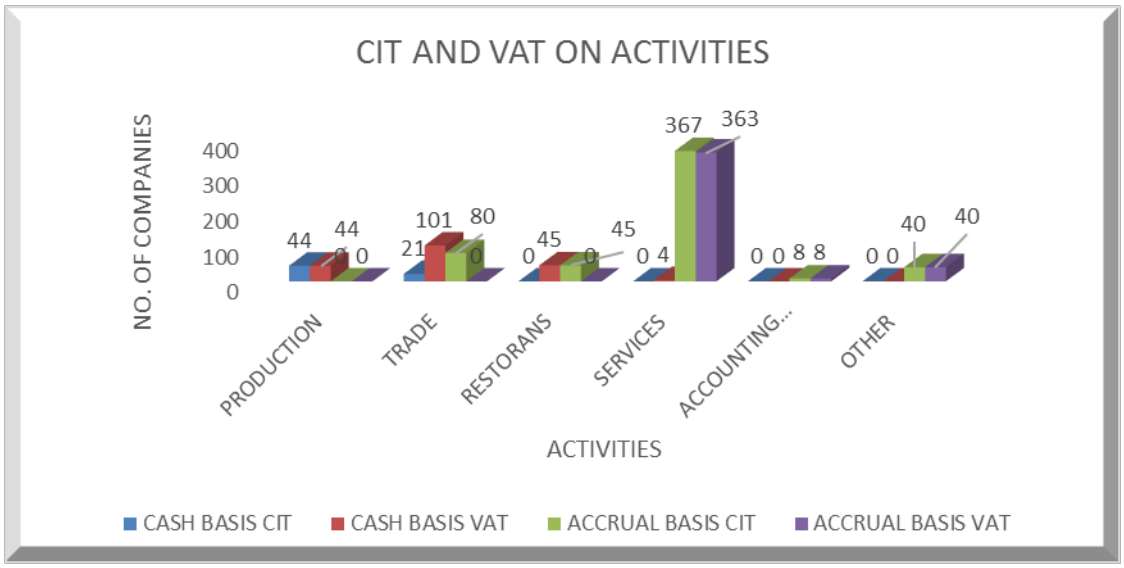


Figure 2: CIT and VAT according to Activities (Author)

Based on the results in Table 1, there is a significant association between VAT payments model and complexity of using the cash basis for the VAT taxpayers (X^2> = 449.636, p < .001). According to the presented frequencies, we have concluded 48,8% of VAT taxpayer do not want take care about the date of payment, or they do not want additional work which they will have using the cash basis. On the second place, 25,6% VAT taxpayer did not choose the cash basis because they have a big number of incoming invoice and they cannot the decrease the outgoing VAT if they have not payed incoming invoices. The first hypothesis is accepted.

Table 1: Chi-square Test between VAT models (Q4) and Complexity of the cash basis model CIT s (Q5) (Authors)

			Q 5				
			NO UNPAID RECEIVABLES	ALL IS PAID IN CASH	DO NOT WANT TAKE CARE ABOUT PAYMENT	A BIGG NUMBER OF INCOMING INVOICES	Total
Q 4	CASH BASIS VAT	Count	38	117	39	0	194
		% within Q 4	19.6%	60.3%	20.1%	.0%	100.0%
	ACCRUAL BASIS VAT	Count	0	0	256	155	411
		% within Q 4	.0%	.0%	62.3%	37.7%	100.0%
Total		Count	38	117	295	155	605
		% within Q 4	6.3%	19.3%	48.8%	25.6%	100.0%

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	449.636[a]	3	.000

a. 0 cells (,0%) have expected count less than 5. The minimum expected count is 12.19.

Based on the results, showed in Table 2, there is a significant association between payments model of CIT and complexity of the cash basis model for the CIT taxpayer (X^2> = 458.002, p <.001). Figures shows that 42 % CIT taxpayers thing that is cash basis system is too complicated, together with 21,8% which things that they need a more people in accounting, and 17.9% CIT taxpayer things that they need a more people and better informatic support for using the cash basis method for payment of CIT. The second hypothesis is accepted.

Table 2: Chi-square Test between CIT models (Q6) and Complexity of the cash basis model (Q8) (Authors)

			Q 8					
			NO UNPAYED INVOICE	IT IS TOO COMPLICATED	NEEDS A MORE PEOPLE IN ACCOUNTING	NEEDS A NEW ACCOUNTING PROGRAM	MORE PEROPE AND INFORMATIC SUPPORT	Total
Q 6	CASH ACCOUNTING	Count	65	0	0	0	0	65
		% within	100.0%	.0%	.0%	.0%	.0%	100.0%
	ACCRUALL ACCOUNTING	Count	18	254	132	28	108	540
		% within	3.3%	47.0%	24.4%	5.2%	20.0%	100.0%
Total		Count	83	254	132	28	108	605
		% within	13.7%	42.0%	21.8%	4.6%	17.9%	100.0%

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	458.002[a]	4	.000
N of Valid Cases	605		

a. 1 cells (10,0%) have expected count less than 5. The minimum expected count is 3,01.

In Table 3 is shown correlations between the size and activity of companies and tax model of VAT or CIT. From this table, we can have concluded that all variables are significant (p < .01).
We obtained statistically significant negative correlations between size and tax model, for VAT r = -.446, and for CIT r= - .884.
We concluded a positive link between activity and tax model for VAT r =-.842, and for CIT r=.634.

The third hypothesis is accepted.

Table 3. Correlations (Authors)

		Size (Q 1) Activities (Q 2)	VAT (Q 4)	CIT (Q 6)
Q 1	Pearson Correlation	1	-.446**	-.884**
	Sig. (2-tailed)		.000	.000
	N	605	605	605
Q 2	Pearson Correlation	1	.842**	.634**
	Sig. (2-tailed)		.000	.000
	N	605	605	605

**. Correlation is significant at the 0.01 level (2-tailed).

Correlation results presented in Table 4 are between tax models and characteristics of cash basis. All correlations are statistically significant ($p < .01$) and positive. We found positive correlations between:

- CIT models and VAT cash model is r = .505. According to the Law, CIT taxpayer according to the cash basis can be only if is VAT taxpayer according to the cash basis. From the total of 194 VAT taxpayers on cash basis, only 65 (33.33%) CIT taxpayer choose the cash basis model.
- CIT models and complexity of tax form is r = .633. The significant positive correlation between the CIT models and complexity of tax form shows that 91.9 % taxpayer thought that PD-NN form is too complicated and demand a lot of manual work, excel sheets and additional human and IT support.
- CIT models and Cash flow report like data sources for fill out tax forms is r = .502. The significant positive correlation between the CIT models and using the Cash flow report like data sources for tax forms shows that 28.1% taxpayer thought that is good sources, but 100% of taxpayer who use cash basis model.
- CIT models and benefit of cash tax model is r = .364. The significant positive correlation between the CIT models and benefit of tax model shows that 99.3 % taxpayer are expected better liquidity, better connections payment of tax and collection of claim.

The fourth hypothesis is accepted.

After all research, all four-statistical hypothesis are accepted, that mean the main hypothesis is confirm: The complexity of obtaining data needed for the tax model according to cash-basis are the main obstacle to the use of the cash model of a bigger number of taxpayers.

Table 4. Correlations (Authors)

		Q 4	Q 6	Q 7	Q 10	Q 12
Q 6	Pearson Correlation	,505**	1	,633**	,502**	,364**
	Sig. (2-tailed)	,000		,000	,000	,000
	N	605	605	605	605	605

5. CONCLUSION

Cash methods of tax payment (CIT and VAT) are implement in Croatian tax system to support micro and small companies to survives due to the increasing lack of liquidity. On the total number of respondents 32.07% have chosen VAT cash payments method and only 10.74% have chosen CIT cash payment method. This is the first year of possibility of CIT cash payments method and result is not so surprising. According to the Law the CIT cash payments method is look like too complicated to take care about to put some figure in PD-NN form during the years of collection of claims.

The basis advantage of cash payments model of VAT and CIT are:

- Payments of taxes only when the taxpayer collected claims or paid the debts,
- Taxpayer won't have to pay VAT or CIT on money they haven't received yet.
- Better liquidity for the companies and for societies

The disadvantage of cash payments model of VAT and CIT are:

- Complexity of the form, especially CIT form
- Complexity of accounting evidence, especially for CIT
- Higher costs for data entry in tax form (required more manual work and informatic support)
- Higher costs of bookkeeping for the required records during the whole period of unpaid claims and unpaid invoices to suppliers until they will finish in tax form.

Years to come, will show the benefit of the tax cash basis models, but for now we can conclude that a lot of micro and small companies did not take the advantage of tax cash basis model because the cash model is too complex and too expensive.

LITERATURE:

1. Accounting Act. (2016). Official Gazette, 75/15, 143/15, 120/16.
2. Croatian Bureau of Statistics: Business entities, situation as on 31 March, 2017, Retrieved 04.05.2017., from http://www.dzs.hr/Hrv_Eng/publication/2017/11-01-01_01_2017.htm,.
3. Council Directive 2006/112/EU, Retrieved, 04.05.2017. from http://eur-lex.europa. eu /LexUriServ/LexUriServ.do?uri=OJ:L:2006:347:0001:0118:en:PDF,
4. Kuliš. D. (2014) Implementation of a cash accounting scheme for VAT: EU experience, Newsletter No. 90 l September 20, institute of Public Finance, Zagreb
5. Law on Corporate Income Tax. Official Gazette. No. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14, 50/16, 115/16)
6. Law on VAT. Official Gazette. No. 73/13, 148/13,143/14, 115/16; Rješenje USRH 99/13, 153/13
7. Osmanović, A. (2016), VAT calculation by cash principle in EU countries, The Research Sector Parliamentary Assembly of BIH, Sarajevo
8. Austria, Retrieved 04.05.2017., from https://www.pwc.com/us/en/ hr-international-assignment-services/assets/austria-folio.pdf
9. Czech Republic, - Retrieved 04.05.2017., from https://www.moorestephens.cz/wp-content/uploads/2016/12/Doing-Business-in-the-Czech-Republic-2016-Moore-Stephens-International.pdf
10. German - Retrieved 04.05.2017., from http://marosavat.com/resources/country/ germany/manual/germany/section/german-cash-accounting/show
11. UK - Retrieved 04.05.2017., from https://www.gov.uk/simpler-income-tax-cash-basis)

BUILDING A RESILIENT ORGANIZATION WITHIN THE COUNTRY RISK'S ENVIRONMENT

Danijela Vukosavljevic
PhD, Assistant Professor, Faculty for Management
Sremski Karlovci , Serbia
vukas45@gmail.com

Dejan Vukosavljevic
PhD, Associate Professor, Faculty for Management
Sremski Karlovci , Serbia
vukosavljevic.dejan@gmail.com

Radmila Grozdanic
Faculty for BA and Entrepreneurship, Belgrade, Serbia
sme_rada@hotmail.com

ABSTRACT

In considering the current global economic instability, new markets and the economy, increasing regulatory requirements, emerging risks and procedures will continue to change and be more complex. As the growing risks consider macroeconomic, strategic and operational risks, on top of which are cyber risks and managing of cyber threats, to research county risks is found challenging. So, the subject of this research is country risk impact on the revenues of the business entities. A total of 92 questionnaires have been distributed to collect the data on the impact of country risk to businesses of enterprises and financial institutions in Balkan countries. There are also desk research results on country risk given for Croatia, Bosnia and Herzegovina, Macedonia, Montenegro and Serbia.

Within the variables of country risk, political and macroeconomic stability are of most concern of these enterprises. Half of the respondents confirm the positive impact of this risk on the sustainability of their revenues in previous years. The result found that Western Balkans banks and enterprises are efficient in country risk analysis, risk monitoring and understanding the country risk in the most significant variables of risk management. For the research have been used statistical methods, linear regression and processing data methods. The contribution of the results can be seen in the support to the importance of shaping the external risks, management and risk culture development.

Keywords: *Balkan countries, commercial banks, country risk assessment and analysis, private enterprises*

1. INTRODUCTION

Changes in the market, competition, and economic, financial and technological changes have led to greater awareness of the companies, banks, institutions and governments of the magnitude of risks and the need of risk management culture development. The present business environment can be described as, a high-risk, especially by financial credit-area, where the necessary actions have to be undertaking to reduce it. Further, the security risks with migration developments have been significantly increased. The recession has hit the budgets for security, at the same time the need for security risks assessment rise. Risk assessment and shaping by enterprises and institutions is becoming increasingly important strategic issue, its monitoring, quantification and analysis of the impact on the sustainability of the businesses, as security and mitigation threats facilities, tangible and intangible assets, economic losses of enterprises, as well as data. The growing awareness of the organization on

the necessity of constant innovation, the production of more sophisticated products and services, greater access to clients is in directly connection with the increase in risk. The most representative providers of the Country risks ratings are: Institutional Investor, Euromoney, Standard and Poor's (S&P), Moody's Investor Services, Political Risk Services (PRS), Economist Intelligence Unit (EIU), The International Country Risk Guide (ICRG). In this sense, the main subject of this Paper is to research the influence of one of the most important external risk- country risk on business entities. The results of the desk research of this risk for Balkan countries as well as, key results of experimental research conducted in 2016 on the attitudes of 92 organizations from these countries on the possible impact of this risk on their financial results in 2015 are presented in this Paper.

2. LITERATURE REVIEW

According to Wilkin (2005) country risk can be defined as the risk of business loss due to country-specific factors- political, financial and economic instability. *Theories of political risks.* The role of politics in international business has long been recognized, it is only in the last 30 years that academic interest has focused on these interactions. Truitt (1974) includes both generic definitions including all non-business risks such as creeping expropriation, and very specific ones such as the loss of control over ownership by Government action. Robock (1971) focuses on the environment rather than upon specific actors which generate political events with adverse implications for business (Ball, 1975; Drysdale, 1972; Levis, 1979). Robock (1971) makes a significant distinction between 'political instability' and political risk (although he claims that the two concepts are related): according to his claims, not all events leading to political instability can be thought of as constituting political risk but, rather, only those that directly affect the local business activity or some of its individual sectors. P*olitical risks* can be traced back to the:

- East India corporation (Barron and Miranti, 1997),
- Russian Socialist Revolution of 1917, the first major shocks to the stability of international private foreign investments were felt, which brought about the nationalization of foreign and domestic investment,
- China, Eastern Europe and Egypt with revolutionary transformations in these countries,
- Mexico (1938) and Iran (1951), classified as strategic, natural-resource exploration infrastructure, Tiananmen Square in China changed what had been considered a safe environment for foreign investment, bringing about $10 billion in uninsured losses, etc.

Economic risks. Three types of country crises have been identified in emerging economies: **economic** crises**, financial** crises and **geopolitical** (or simply **political**) crises (Hoti and McAleer, 2004).

Theories of Currency Crises. A review of the theory regarding currency crises is best done utilizing the three generations of models.

- The first-generation models are connected with Krugman (1979) and Flood and Garber (1984), built on work by Salant and Henderson (1978). The key focus of these models was that macro-policies, broadly defined, can: be inconsistent when combined with fixed or pegged exchange rates, lead to an unsustainable situation and be followed by a currency adjustment. In general, these first-generation models claimed that it is either macroeconomic policy inconsistencies or

microeconomic weaknesses that lead to inevitable currency adjustments which could cause a sudden loss in foreign-exchange reserves when market participants realized that the existing exchange rate was no longer viable indefinitely.

- The second generation of currency crisis models began perhaps with Obstfeld (1986): Obstfeld stressed that there may be tradeoffs between the various policy objectives pursued by a country where the inflation and employment may face some tradeoffs, as in the traditional Phillips curve. The government may be indifferent between an outcome of low inflation and high unemployment or an outcome of high inflation and low unemployment. The low-inflation equilibrium may be associated with a fixed exchange rate and the high-inflation outcome with a floating foreign-exchange regime or another fixed, but gradually depreciated exchange rate. If the government is indifferent, either equilibrium may be sustained, thus opening up the possibility of multiple equilibriums, and associated sudden currency adjustments. According to the same generation of models, prospective fiscal deficits caused by a collapse of a banking system and the need for a fiscal bailout may also trigger a currency crisis – the expectation of the government having to bail out a banking system may cause lenders to withdraw their funds, thus triggering the collapse of the currency and – ultimately – the crisis (Burnside, Eichenbaum and Rebelo, 2001). This has been labeled as the "self-fulfilling" currency crises (Obstfeld, 1986).
- Other related models, like the one developed by Blanchard and Watson (1982), model the collapse of a speculative bubble that was itself a rational equilibrium (Hamilton, 1986; Meese, 1986; Woo, 1984). The bubble, however, was nevertheless irrational (ex post) and also had a positive probability of collapsing all along. While this type of speculative bubble modeling has been traditionally applied to stock-market crashes, in some cases such as in Russia in the summer of 1998 when the exchange rate and the fiscal situation were being supported by large capital inflows, it can be also appropriate.

The effect for the country, however, is a loss of aggregate liquidity that triggers a currency or financial collapse. A crisis in one country may also teach investors about fundamentals in other, similar countries. This is not necessarily contagion but, rather, learning about the true model of risk. In one sense, this concept and some of the other contagion models are more a part of first- or second-generation currency and banking crisis models.

Theories of Banking Crises. There are two types: individual and system-wide. The theory regarding causes of the first type takes a more micro view and has been applied extensively to the empirical models used mainly in developed countries to predict financial distress. Reviewing this theory is important here because individual banking crises may also lead to systemic distress, depending of course upon various other factors. Much of the literature on bank runs has modeled the phenomenon as an asymmetric information problem between depositors and banks. Early reviews consider these banking panics as random manifestations of mass hysteria, a model formalized in Diamond and Dybvig's (1983) seminal study. Another version of this theory is that bank runs systematically relate to events that change the perception of depositors' risk – such as extreme seasonal fluctuations (Miron, 1985), unexpected failure of a large financial institution or major cyclical downturns (Gorton, 1988).

At the system level, macroeconomic factors can have a particular effect to initiating or amplifying banking crises, either because they trigger sudden capital outflows (Calvo, Leiderman and Reinhart, 1994), or because of their effects on the portfolios of domestic banks (Chinn and Kletzer, 2000). *Early Warning Systems (EWS) Theories.* These theories consider models that can not only identify weaknesses in emerging-market economies, but also hope to send timely and correct signals about the onset of a financial crisis. Such models have rightly then been called Early Warning Systems (EWS).

3. METHODS AND MATERIALS

In this part of the Paper are presented key results of desk research on Balkan countries Croatia, Bosnia and Herzegovina, Macedonia, Montenegro and Serbia, on country risk, and the results of the field research of 92 enterprises and financial institutions form these countries on country risk assessment and management in favor to business results.

3.1. Desk research results on Balkan coutries country risk

Croatia

Core Views. Croatia's short-term economic outlook has improved considerably as domestic demand recovers faster than anticipated and robust growth eases some of the country's macroeconomic imbalances. GDP is expected to return to its pre-crisis high by 2020. Public debt has peaked and should begin to fall gradually. However, reforms to boost medium-term growth and reduce the budget deficit will be vital to ensure debt remains on a sustainable path once global interest rates begin to rise. *Major Forecast Changes.* GDP growth in 2016 to 2.7% can be further forecasted for 2017 to 2.9% on account of a robust recovery in household consumption and investment activity. Higher-than-expected revenue growth has accelerated fiscal consolidation, and reduced deficit target for 2017 to 2% of GDP, down from a revised estimate of 2.2% in 2016. Base effects from deep deflation and the anticipated rebound in oil prices expected after OPEC agreed to cut production in November have revise up the average inflation forecast for 2017 to 1.6%, from a previous 1.3%. *Key Risks.* The burdensome debt pile leaves the country highly exposed to shocks in financial markets or interest rate hikes that raise the cost of servicing debt. If the government does not implement structural reforms that draw fresh investment in, the country's medium-term growth outlook will become gloomier. The need to take unpopular political decisions could once again lead to divisions within the governing coalition, endangering the progress of reforms.

Table 1. Macroeconomic Forecasts for Croatia, 2015-2018

Indicator	***2015***	***2016e***	***2017f***	***2018f***
Real GDP growth, % y-o-y	38.7	43.9	45.4	47.2
Nominal GDP, USDbn	1.6	2.7	2.9	2.6
Consumer price inflation, % y-o-y, eop	0.1	0.3	1.8	2.3
Exchange rate HRK/USD, eop	7.04	7.43	7.50	7.67
Budget balance, % of GDP	-3.2	-2.2	-2.0	-1.7
Current account balance, % of GDP	5.8	3.8	3.4	2.9

E/f = BMI estimate/forecast.
Source: National Sources

Crime and Security (72.0/100). Croatia presents investors with limited risks from a crime and security perspective and is not a specific target of any international terrorist groups. The country is generally considered one of the safest in the region, with low violent crime rates, and benefits from a highly capable and reliable police force.

Financial crime is a potential risk area, particularly in conjunction with the high levels of corruption in government, which create the need for additional due diligence when competing for public contracts.

Serbia

Businesses operating in Serbia face supply chain disruptions and reduced productivity stemming from the poor quality of the transport network, prevailing regional economic headwinds and an increasingly limited pool of skilled labour. Despite notable progress in implementing internal reforms to assist its EU accession process, the country's judicial system remains weak and corruption permeates all public institutions, raising investment risks and direct legal costs. Businesses will continue to face onerous tax obligations and tight lending conditions, even as austerity measures ease over the medium term.

Serbia **is a relatively security risk-intensive country** by regional standards due to the proliferation of organized crime and significant ethnic and interstate tensions that have contributed to strained diplomatic relations with regional peers such as Kosovo.
Serbia sits in ninth place out of 12 states in South East Europe in Operational Risk Index, ranking behind Turkey and Macedonia but ahead of Albania and Bosnia and Herzegovina. Nevertheless, Serbia's medium- term outlook is significantly brighter due to improving literacy rates, low direct labour costs, public sector reforms and the country's push towards strengthening economic openness and diversification.

Crime and Security (46.8/100). Serbia's major crime and security risks stem from the ongoing refugee crisis inflaming nationalist tensions and heightening the risk of terrorism. Meanwhile, significant police corruption, operational inefficiency combined with the prevalence of organised, financial and petty crime contribute to heightened security and insurance costs for businesses compared to other countries in the region with less security risks such as Poland, Croatia and Slovenia. Though cyber defenses and military capabilities are low, international assistance and training programmes are seeking to get Serbia's various security bodies up to an acceptable standard in the country's quest for EU accession.

Table 2. Crime and Security Risk for some Balkan countries in 2017

Crime &Security Risk			
	Serbia	Croatia	Bosnia and Herzegovina
Country Score	46.8	72.0	59.2
Southeast Europe Average	58.7	58.7	58.7
Southeast Europe Position (out of 12)	11	2	7
Global Average	49.9	49.9	49.9
Global Position (out of 201)	112	35	71

Note: 100 = lowest risk; 0 = highest risk.
Source: BMI Operational Risk Index

Core View. Serbia's ruling Progressive Party (SNS) emerged as the winner of the April 24 general election, which will reaffirm public support for Prime Minister Aleksandar Vucic's austerity agenda and structural reform programme. The principal political risks to the current Serbian government are regional. Serbia's rising migrant population is placing an increasing burden on Serbia's social stability, and poor relations with Croatia and Kosovo are delaying Serbia's EU accession.

Domestically, with its large majority in parliament, the government is tasked with ensuring that it implements its own manifesto effectively and overcome the challenges from the newly-elected far-right parties and the fractured opposition.

The recovery of Serbian real GDP growth will consolidate in 2017 and 2018 on the back of rising consumer spending, substantial investment, and less severe government austerity. Growth will be limited, however, by rising imports, and unreformed state-owned enterprises. It is forecasted GDP growth (BMI) of 2.8% in 2017, and 3.1% in 2018. Serbia's current account deficit will stabilise in 2017 on account of weaker external demand, stronger import demand, and rising commodity prices. However, the deficit does not pose a major risk to economic stability, given that structural reforms are increasing export potential and attracting more foreign direct investment. The current account deficit is forcasted (BMI) at 3.3% of GDP and 3.2% in 2017 and 2018, respectively. The National Bank of Serbia will begin a rate hiking cycle in 2017, bringing the main policy rate to 4.50%. Stronger domestic economic performance and rising global commodity prices, alongside rising developed economy rates will prompt the cycle. The pace of fiscal consolidation in Serbia will slow in 2017 on account of slowing reform momentum, weaker revenue collection and politically motivated spending hikes. Government debt will remain high at 71.5% of GDP in 2017, leaving Serbia's fiscal position and sovereign creditworthiness vulnerable to shocks.

Key Risks. It could be protected relatively positive long-term view on Serbia grounded in Prime Minister Aleksandar Vucic's credible market-friendly and structural reform of the public sector, along with the prospects of EU accession providing a policy anchor for the Serbian government. While the path towards EU membership is much clearer now that an agreement has been reached with Kosovo, continued progress in implementation and enforcement of the accord is required.

Table 3. Macroeconomic Forecasts for Serbia, 2015-2018

Indicator	***2015***	***2016e***	***2017f***	***2018f***
Real GDP growth, % y-o-y	0.8	2.8	2.8	3.1
Nominal GDP, USDbn	37.2	37.5	37.7	39.8
Consumer price inflation, % y-o-y, eop	1.5	1.6	2.6	3.3
Exchange rate RSD/USD, eop	111.89	117.30	120.59	119.61
Budget balance, % of GDP	-3.7	-1.4	-1.5	-1.8
Current account balance, % of GDP	-4.7	-4.0	-3.3	-3.2

E/f = BMI estimate/forecast.
Source: National Sources

Montenegro

The limited sovereign fiscal headroom linked to the country's ability to return to a sustainable macro-fiscal path is the main risk to delivery under the proposed strategy. Public debt is high at 65 per cent of the estimated 2016 GDP, which is above the median for similarly rated countries. The proposed priorities are likely to increase exposure to the sovereign, particularly the focus on cross-border transport, for which projects often have sovereign guarantees. The proposed strategy for Montenegro is ambitious as it matches the Government of Montenegro's own very ambitious reform programme with the overall risk to the Country Strategy implementation rated as high. The prospects of an incremental operational response in infrastructure, private sector lending and privatisations are dependent on reforms and progress in the project implementation capacity of the administration, the government's privatisation programme of remaining SOEs, utilisation of the fiscal headroom and the

resolution of the NPL problem. Furthermore, fiscal prudence would require difficult political decisions, including reversal of recent policy measures. Should this risk materialise, the results under the 2nd and partly 3rd strategic priority will be reassessed at the time of the Country Strategy Delivery Reviews and the programme would be scaled down and readjusted through reallocation of some resources towards investment operations supporting the country in strengthening its resilience to shocks and advance towards a private-sector driven, inclusive growth model under Priority 1. It has been stipulated with the European Commission that the Government of Montenegro will issue sovereign guarantees only for infrastructure projects, as well as for loan facilities identified to contribute to economic development of the country, such as projects where the assessment is that there is no risk for the guarantees to be called. Political and governance risks are substantial.

Excessive number of banks for a very small economy, depressed credit demand, significant NPLs and low profitability hamper growth prospects for the banking system. Growth in the size of the tourism industry could increase macroeconomic volatility, with the economy becoming more sensitive to the health of neighboring economies. Insufficiently developed infrastructure leaves Montenegro relatively isolated from its neighbors. While this provides some degree of protection from new entrants, it constraints successful corporates from expanding beyond the borders. Environmental and social risks are substantial. The country is vulnerable to natural disasters and climate change-related risks. Should a serious a serious event occurs during the strategy implementation, it could derail the achievement of intended development results particularly under Priority 3 where focus is on the development of sustainable tourism. These risks will be mitigated by supporting more effective industrial waste disposal, addressing climate change challenges as part of integrated water resources management and climate change adaptation in national planning, with a view to support investments that enhance and preserve the country's national resources.

Macedonia

Core Views. President Gjorge Ivanov's blocking of the formation of a coalition government on March 2 marks a dangerous moment in Macedonia's ongoing political crisis and reaffirms our long-held view that political stability will remain elusive for the foreseeable future. Policy deadlock and rising ethnic and even geopolitical tensions could all follow Ivanov's decision.

Major Forecast Changes. International financial institutions have lowered Macedonia's Short-Term Political Risk Index score from 51.7 to 44.6 out of 100 on account of worsening policy-making process and policy continuity after the president's blocking of a coalition government being formed in early March. *Key Risks.* Political risk will remain elevated in the EU over the course of 2017, with elections in France, the Netherlands and Germany potentially giving rise to more euroscepticism and further setbacks to Macedonia's EU accession hopes. A deeply divided legislature and elevated ethnic tensions threaten to delay further structural reforms over the coming years.

Table 4. Macroeconomic Forecasts for Macedonia, 2015-2018

Indicator	***2015***	***2016e***	***2017f***	***2018f***
Real GDP growth, % y-o-y	3.8	3.1	3.0	3.0
Nominal GDP, USDbn	10.1	10.2	10.0	10.4
Consumer price inflation, % y-o-y, eop	-0.3	-0.2	1.9	2.5
Exchange rate MKD/USD, eop	56.49	58.48	60.29	60.29
Budget balance, % of GDP	-3. 5	-2.8	-2.5	-2.5
Current account balance, % of GDP	-1.4	-3.0	- 2.4	-2.3

Source. National bank

Bosnia- and Herzegovina

Economic growth accelerated in the latter stages of 2016 and should continue that momentum through 2017 and 2018 and consumer and investor confidence improves on the back of recent deals with the IMF and progress - albeit minimal - towards EU accession. Budget policy will be anchored by the three-year IMF lending agreement, especially as the entity governments rely on external funding to cover budget deficits. This should ensure short-term financial stability and fiscal discipline, though has so far done little to address deeper structural problems.

Major Forecast Changes. The estimation for GDP growth in 2016 has been from 2.7% to 2.5% due to weaker-than-expected revised figures, and target for 2017, 3.0%.

Key Risks. Further delays in the distribution of funds under the new EUR550mn agreement with the IMF could lead to financing problems in both entity governments.

Table 5. Macroeconomic Forecasts (Bosnia-Herzegovina 2015-2018

Indicator	***2015 e***	***2016e***	***2017f***	***2018f***
Real GDP growth, % y-o-y	14.3	14.5	15.1	15.8
Nominal GDP, USDbn	3.2	2.5	3.0	3.4
Consumer price inflation, % y-o-y, eop	-1.3	-0.2	1.5	2.6
Exchange rate BAM/USD, eop	1.80	1.86	1.92	1.92
Budget balance, % of GDP	0.7	-0.7	- 1.1	-1.1
Current account balance, % of GDP	-5.7	-6.1	- 6.3	-6.4

E/f = BMI estimate/forecast.
Source: National Sources

Crime and Security (59.2/100). Bosnia continues to face significant security challenges in the wake of the 1992-1995 war. Strong affiliation on the part of some Islamic extremist groups in the country with international terrorist organisations are permanent threat. Somewhat offsetting these risks is the very low rate of crime in the country which does help to ensure that businesses are presented with a safe and secure operating environment on a day-to-day basis. Foreign workers and businesses are very rarely the targets of crime, with Bosnia's organised criminal gangs more focused on people and drug trafficking than corporate related crime. At present there is also limited risk from cybercrime, though as the country's internet infrastructure develops this will become more of a challenge as Bosnia lacks sufficient expertise or manpower to tackle modern cyber warfare.

3.2. Field research results

The field research has been provided on risks assessment and management in some Balkan countires: Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia on the attitudes of the 60 enterprises and 32 financial institutions. In this paper are presented the key results on country risk assessment with its components.

Chart following on the next page

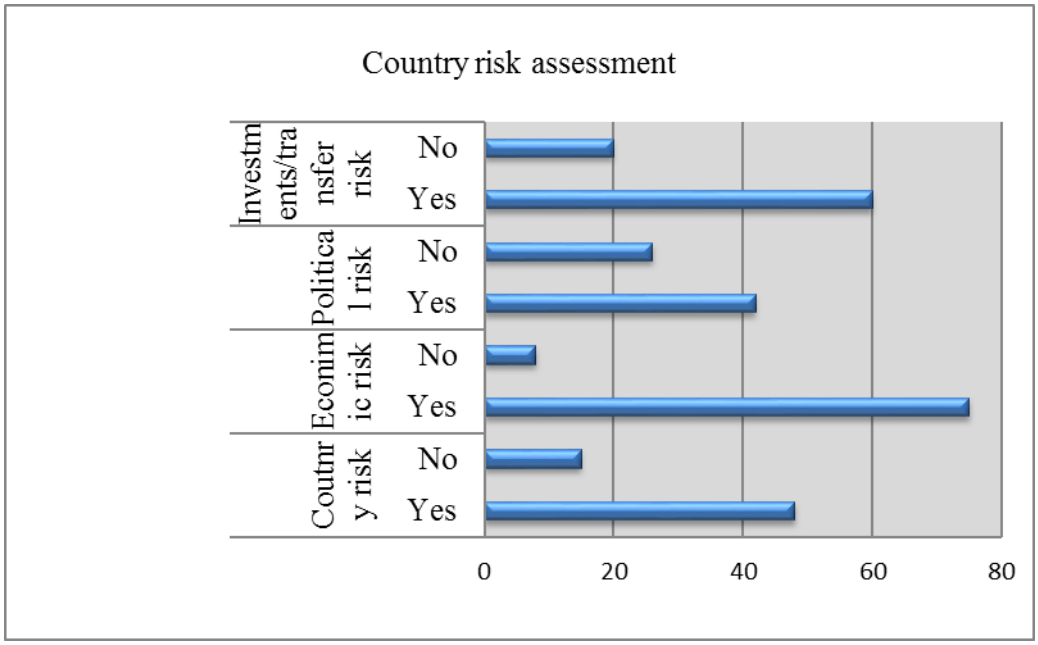


Chart 1. Courntry risk assessment
Sources: Authors

The main hypothesis was that this kind of risk impacted on the revenue of the companies, in a way to decrease it, to sustain it or increase it.

Within the sample 26, 55% of enterprises had the income less than 100 000 euro in 2015, 27, 43% to half a million euro, and other above 2 million euro. 46% of companies believe that country risk management help sustainability of their income, 28%, that impact has been negative and decrease the income, and other believe that impact has been positive to the increase of their income.

Analyzes of the impact of specific external risks includes one of the most significant - risk of the country which has been assessed by the surveyed entities with the aim to measure its impact on their performances, mainly financial results. There were formulated ten dichotomous variables different: Macroeconomic Stability, Political Stability, Structural changes, External debt / debt service tidiness, Country access to international financial institutions, Height of inflation, Unemployment, Domestic currency trend, Foreign currency trend and Human Development Index, as the ways this risk can be manifested, and the results of their impact are shown in Table 6 and Chart 2.

Tabela 6. The number of observations, the mean value and standard deviation of different types of country risk – (*Ends on the next page)*

Variable	Dichotomous variables	No.of postive responses	Proportion (*p*)	Standard deviation
X_1	Macroeconomic Stability	44	0,3894	0,2378
X_2	Political Stability	49	0,4336	0,2456
X_3	Structural changes	13	0,1150	0,1018
X_4	External debt / debt service tidiness,	6	0,0531	0,0503

X_5	Country access to international financial institutions	16	0,1416	0,1215
X_6	Height of inflation	25	0,2212	0,1723
X_7	Unemployment	24	0,2124	0,1673
X_8	Domestic currency trend	13	0,1150	0,1018
X_9	Foreign currency trend	23	0,2035	0,1621
X_{10}	Human Development Index	4	0,0354	0,0341

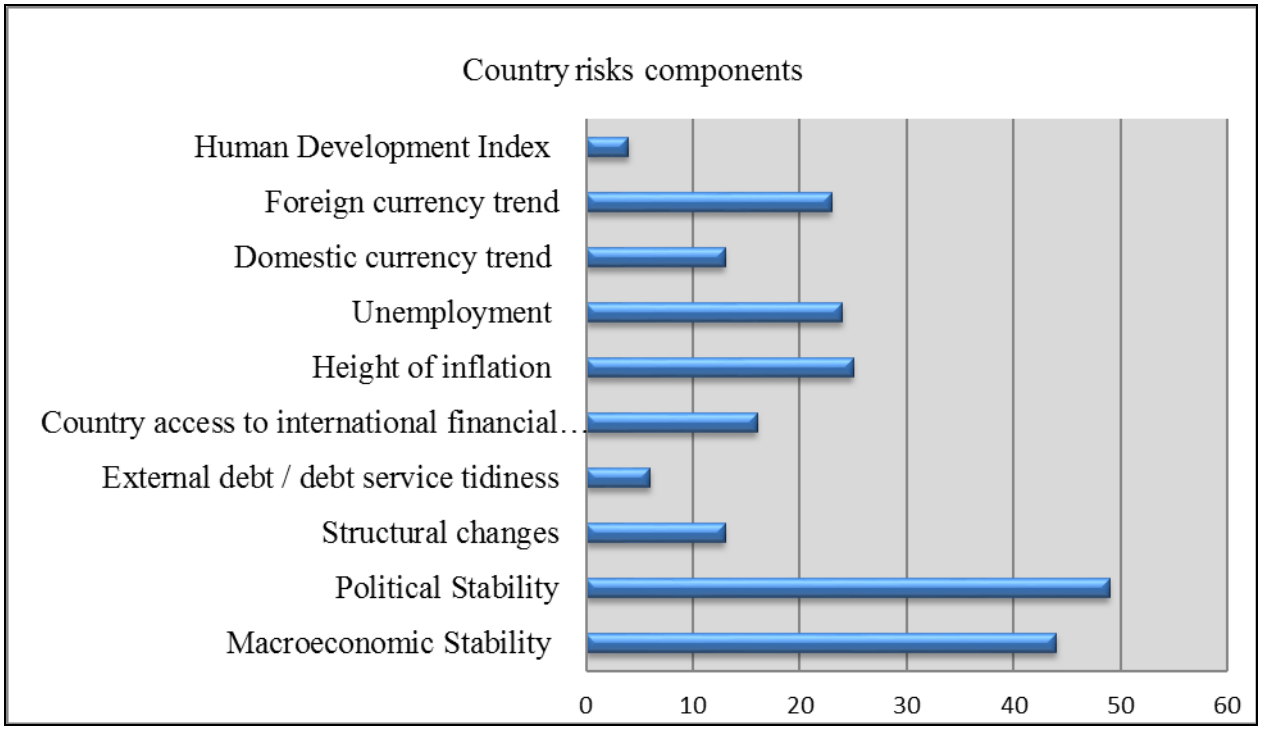


Chart 2. Coutry risk components
Sources: Authors

In addition to the variables themselves, Table 7 contains the basic statistical parameters of distribution the total number of positive responses, and their proportion of the appropriate standard deviation.

According to the processed data, it can be seen that the largest number of enterprises and financial institutions as a particular type of countries risk noted - *political stability* (variable X2), and then immediately emphasized *macroeconomic stability* (variable X1). Slightly more than a fifth of respondents answered positively to the impact of external risks such as the *inflation rate* (variable X6), *unemployment* (variable X7) and the *trend of foreign currency* (variable X9). The value of the remaining five variables is less pronounced. In the analysis of the attitudes of the respondents about the impact of different types of country risk, their relationship and influence on the size of the earned income of the surveyed companies / institutions is tested in 2015. The estimated values of the coefficients logistic-regression model and defined dichotomous variables, together with OR-values and the estimated values to standard errors are shown in Table 7.

Tabela 7: Realized value relationships ratios (OR) and the estimated value of the coefficients of logistic regression

Variable	Dichotomous variables	OR	Regression coefficient	Standard error
Regression constant			0,3861	0,1161
X_1	Macroeconomic Stability	0,6337	0,1633	0,1093
X_2	Political Stability	0,7656	0,0091	0,1100
X_3	Structural changes	0,1300	-0,0898	0,1782
X_4	External debt / debt service tidiness,	0,0561	-0,0636	0,1466
X_5	Country access to international financial institutions	0,1649	0,2485	0,1389
X_6	Height of inflation	0,2841	0,0113	0,1138
X_7	Unemployment	0,2697	0,0102	0,1799
X_8	Domestic currency trend	0,1300	0,0745	0,1463
X_9	Foreign currency trend	0,2556	0,0473	0,1082
X_{10}	Human Development Index	0,0367	-0,0743	0,1626
The total error (Q):	0,2534			
Determination coefficient (R2):	0,8290			
AIC:	13,858			

According to the survey, most of the values of the regression coefficient are positive. There is a (mostly) positive correlation of relevant variables, i.e. the impact of country risk with the amount of earned income. The most obvious impact, expressed the highest positive value of the regression coefficient has, as expected, the coefficient X5, which refers to the impact of risk of *ccountry access to international financial institutions.* Immediately followed by a variable X1, i.e. the impact of the risk of macroeconomic stability.

In contrast, the variable X3, X4, X10: the risks of structural changes, and the external debt and human development index have negative estimated value of the regression coefficients, and further an negative influence on the total income of the surveyed entities. However, it should be noted that the estimated value of the regression coefficients, and the remaining five positive, very small (of the order 10-2). Therefore, the impact of all of these kinds of country risk, from a statistical point of view, can be considered insignificant. Quantitative and statistical quality parameters logistic-regression model (Q = 0.2534, R 2 = 82.90%, AIC = 13,858) indicate its expressed quality.

4. DISCCUSION AND CONSLUSIONS

A summary of threats and trends in the field of risk may affect the functioning of the economy and banks in the coming period. It would be supported by permanent regulatory changes and increased control that will affect the way in which products or services will be produced or supplied. Economic conditions in the markets will significantly limit the

possibilities of development for the organizations. The organization will not be sufficiently prepared to manage cyber threats that have the potential to significantly disrupt the basic operation and / or damage the brand. Risk culture of an organization could not be fast enough to identify problems and escalating risks that have the potential to significantly affect the basic operations and achieve strategic goals. Because of these reasons, the resutlsof the research in this Paper support risk management cuoloture which would be important for the realization of strategic goals in industries due to increased volatility and complexity; the ability of organizations to manage risk will be of greater importance for long-term growth and future profitability. The future of risk management needs more proactive approach in order to develop a competitive advantage and maintain profitability and growth in the environment where country, political risks are of great importance.

LITERATURE:

1. Ball, G. W. (1975). Global Companies: The Political Economy of World Business, Englewood Cliffs, NJ: Prentice-Hall.
2. Baron, J., Miranti,P. (1997). History of Corporate Finance, Cambridge: Cambridge University Press.
3. Blanchard., O. Watson, M. (1982). Bubbles, Rational Expectations and Financial Markets, in Paul Wachtel (end) Crises in the Economic and Financial Structure, Lexington: Lexington Books.
4. Burnside., C.., Eichenbaum , M., Rebelo, S. (2001). Prospective Deficits and the Asian Currency Crisis, Journal of Political Economy, Vol. 109, No. 6, pp. 1155 – 1197.
5. Calvo, G., Leiderman, L., Reinhart, C. (1994). Capital Flows and Macroeconomic Management: Tequila Lessons, International Journal of Finance and Economics, Vol. 1, No. 3, pp. 207 – 224.
6. Chinn, M., Kletzer, K. (2000). International Capital Inflows, Domestic Financial Intermediation and Financial Crises under Imperfect Information', NBER Working Paper Number 7902, National Bureau of Economic Research, Cambridge, MA, September.
7. Diamond, D.W. and P.H. Dybvig 1983, 'Bank Runs, Deposit Insurance and Liquidity', Journal of Political Economy, Vol. 91, No. 3, 401 – 419.
8. Drysdale, P. 1972, 'Direct Foreign Investment in Asia and the Pacific', Canberra, Australia: Australian National University Press.
9. Flood, R.P. and P.M. Garber 1984, 'Collapsing Exchange-Rate Regimes: Some Linear Examples", Journal of International Economics, 17, pp. 1 – 13.
10. Gorton, G. 1988, 'Banking Panics and Business Cycles', Oxford Economic Papers, Vol. 40, No. 3, pp. 221 – 255.
11. Hamilton, J. 1986, 'On Testing for Self-Fulfilling Speculative Price Bubbles', International Economic Review, Vol. 27, No. 3, pp. 545 – 552.
12. Hoti, S. and M. McAleer 2004, 'Country Risk Ratings: An International Comparison', Journal of Economic Surveys, Vol. 18, No. 4, pp. 539 – 588.
13. Krugman, P. 1979, 'A Model of Balance-of-Payments Crises', Journal of Money, Credit and Banking, Vol. 11, No. 3, pp. 311 – 325.
14. Levis, M. 1979, 'Does Political Instability in Developing Countries Affect Foreign Investment Flow?: An Empirical Examination', Management International Review, Vol. 19, No. 3, pp. 59 – 68.
15. Meese, R. 1986, 'Testing for Bubbles in Exchange Markets: The Case of Sparkling Rates', Journal of Political Economy
16. Miron, J. (1985). 'Financial Panics, the Sensitivity of the Nominal Interest Rate and the Founding of the Fed', American Economic Review, Vol. 76, No. 1, pp. 125 – 140.

17. Obstfeld, M. 1986, 'Rational and Self-Fulfilling Balance of Payments Crises', American Economic Review, Vol. 40, No. 3-5, pp. 1037 – 1047.
18. Robock, S. H., (1971). Political Risk: Identification and Assessment. *Columbia*
19. *Journal of World Business*, Jul/Aug, 6 (4), 6-20.Truitt, J. F. (1974). Expropriation of Private Investment, Indiana: Division of Research, Graduate School of Business, Indiana University.
20. Salant, S. and D. Henderson 1978, 'Market Anticipation of Government Policy and the Price of Gold', Journal of Political Economy, 86, pp. 627 – 648.
21. Wilkin, S. 2005, About CountryRisk.com, URL: http://www.countryrisk.com/about/
22. Woo, W. 1984 'Speculative Bubbles in Foreign Exchange Markets', Brookings Discussion Papers in International Economics, No. 13, Brookings.

THE STUDY OF NATIONAL INNOVATION SYSTEMS: PURPOSE, CRITERIA AND FUNCTIONS

Yuliya Razvadovskaya
Research Center "Instrumental, Mathematical and Intellectual Support of Economy", Southern Federal University, Rostov-on-Don, Russia
yuliyaraz@yandex.ru

Timur Sinelnikov
Department of Engineering Economics, Southern Federal University, Rostov-on-Don, Russia
t.sinelnikov@gmail.com

Anton Afanasyev
Research Center "Instrumental, Mathematical and Intellectual Support of Economy", Southern Federal University, Rostov-on-Don, Russia
afanasyevanton@sfedu.ru

Anna Khanina
Department of management and innovation technologies, Southern Federal University, Rostov-on-Don, Russia
ahanina@sfedu.ru

ABSTRACT

Over the past years, researchers have widely used the concept of national innovation systems to substantiate the relationship between existing institutions involved in facilitating technological advances and the process of creation and diffusion of innovation. In this context the study of the concept of a national innovation system was conducted, aimed at considering the purpose, criteria and functions of a national innovation system. The study includes the review of theories of development of national innovation system, the theory of competitive advantage and the theory of endogenous growth, developed by M. Porter, P. Romer and R. Nelson. These theories became a context for the research of the innovation system at the macro level, resulted in identification of the purpose of the innovation system. The article highlights a special role of dynamic capabilities, as the ability of the organization to reconfigure the existing resource base through the generation and modification of knowledge for increasing economic efficiency in the process of continuously changing internal and external conditions within a national innovation system. The article specifies main factors of competitiveness of a national economy and defines national innovation system as an environment which impacts development, spreading and transfer of new knowledge and technologies. The proposed approach allowed to determine the output of the national innovation system as the process of generation, spreading and implementation of new knowledge.

Keywords*: dynamic capabilities, endogenous growth; innovation; inputs and outputs; national innovation system; theory of competitive advantage*

1. INTRODUCTION

Long-term economic growth is based on production efficiency processes due to introduction and diffusion of new technologies into industrial sectors of the economy. The competitiveness of individual countries depends on the tendency of national industries to innovate and upgrade [21]. The classical definition of innovation refers to works of

J. Schumpeter, since then the definition has been expanded, according to the study of M. Crossan and M. Apaydin “innovation is both a process and an outcome; is a production or adoption, assimilation, and exploitation of a value-added novelty in economic and social spheres; renewal and enlargement of products, services, and markets; development of new methods of production; and establishment of new management systems” [3]. This definition presupposes the existence of several innovative development strategies, focused on domestic production of new technologies, as well as a strategy of borrowing new technologies from more technologically advanced countries. These new technologies and innovations in the current economic conditions serve as a basic resource that ensures the competitiveness of the national economy. The process of generation and diffusion of innovation is carried out in the framework of the national innovation system, which includes the network of organizations involved in the development, spreading and implementation of innovation [4]. Different innovation systems can be assessed and compared in terms of functions they fulfill [1]. However, apart from the definition of functions, another important and arguable issues to study are the boundaries of the innovation system. The complexity of this process is determined by the absence of the correct or incorrect way to discover the limits of the system so the system is a theoretical construct and usually is adopted to and described for the purposes of a specific research.

2. INNOVATION CONCEPTS: NATIONAL INNOVATION SYSTEMS AND ENDOGENOUS GROWTH

The founder of the theory of national innovation systems is R. Nelson, he studied the economic development process from the standpoint of evolutionary changes of the economy, and believed that “traditional economic theory is based on the ideas of general economic equilibrium, has shown to be ineffective... So it makes no sense to analyze the equilibrium, it is important to understand how change happens” [22]. Underlying concept of the evolutionary development of economic systems in this context is borrowed from biology and refers to the core principles of “natural selection” in the process of economic development. From this perspective, the competitiveness of enterprises is determined by their ability to survive. In this case, “differentiation in growth and viability within a population of firms can produce changes in aggregated economic indicators of the population, even if the corresponding characteristics of individual firms remain unchanged” [22]. These processes rely on the principles of organizational genetics, i.e. the transmission over time of the organizations’ characteristics which refer to the production of new or improved products, and profit extraction. An important premise of Nelson`s theory is the allocation of a “set of production capacity” firms, which consist of a set of knowledge and skills, applied technology and economic activities. Thus enterprises in terms of a production-possibilities set apply these combinations of resources and knowledge to maximize profits. In this regard, the national innovation system should provide a variety of production capabilities, which firms try to combine to increase competitiveness in the relevant markets of goods and services. The ability of the company to recombine resources in a given set of production possibilities can be characterized as dynamic capabilities of the organization. Dynamic capabilities represent the ability of an organization to reconfigure the existing resource base on the basis of the generation and modification of knowledge aimed at increasing economic efficiency of the process of continuously changing internal and external conditions. According to R. Nelson and other researchers, the innovation system is a kind of a platform that allows to link intellectual capital and knowledge to domestic economic growth and competitiveness [15, 9, 12]. Thus, from the standpoint of Nelson`s theory the fundamental factor of the innovative development in the framework of the national innovation system is new knowledge that allows organizations to survive in a competitive environment through a

combination of existing resources in a way that ensures maximization of profits. Endogeneity of the progress is ensured with regard to the process of training in the application of assets (capital). Nelson's ideas are supported by P. Romer, who also considered new knowledge as a main factor of economic development. In P. Romer extended the concept of Capital by including human capital and intellectual capital (knowledge) [19], which is one of the most important endogenous factors of economic growth (endogenous growth model by P. Romer and K. Arrow). According to R. Nelson and P. Romer [16] education and R&D are areas with a high level of ideas generation and skills development, that have a significant impact on economic growth. The growth of knowledge capacity (intellectual capital), according to D. Landes explains the per capita income increase in the leading world economies [11]. Therefore, a well-developed national innovation system forms the system of interconnection between science, government, industry and society, where economic development is based on innovation and the demand of innovative development stimulates the development of scientific (R&D) activity. The core conceptual provisions of the theory of endogenous growth are the following: the idea of organizational routine (i.e. knowledge, hidden from external observation) and methods of application of this knowledge; search refers to all activities of the organization that are associated with the evaluation of current routines, that may lead to their complete modification or replacement; the selective environment consists of factors that affect a welfare of an organization and its growth (including not only external conditions, i.e. demand and competition, but also a behavior and characteristics of other enterprises in the industry).

3. THE THEORY OF COMPETITIVE ADVANTAGE

Innovation as a process of transforming knowledge into new products, processes and services, according to M. Porter and S. Stern, is not limited to R&D, it is also expressed in innovations and improvements in the field of marketing, logistics and service provision (including customer satisfaction) [17]. So the introduction of a major technological innovation to an industry allows a company to lower costs (temporarily) and make significant progress in case of product differentiation, ensuring successful implementation of both strategies [21]. The achievement of the desired effects may be ensured via introduction of new (automatic) computer technologies and techniques, as well as implantation of new methods of management and application of information technology. Another factor that determines success of an enterprises in a competitive environment is a corporate culture. Strategy of differentiation is easier to implement in a culture (environment) which encourages innovation, individualism and venture. This culture is a mean of obtaining essential competitive advantage, not an ultimate goal. In addition to corporate culture Porter underlines the importance of national values, culture, economic structures, and existing organizations innovative development. One of the major factors of innovative development of economy is an appropriate institutional structure, including rules of distribution of property and income, setting a pattern of requirements and a collective consumption, which defines the model of innovative development. Conditions generated in the national economy can be viewed as the characteristics of the environment conducive to the development of innovative activity. Such characteristics of the environment include availability and the level of development of infrastructure and a skilled workforce. Another aspect is the state of the demand and its nature in the domestic market for goods and services, as well as the presence or absence of related or supporting industries that are competitive in the world market. These conditions, according to M. Porter, are crucial in shaping the national environment to maintain the competitiveness of companies in international markets of goods and services.

If the state is capable of maintaining incentives (in regard to enterprises) for constant concentration and reproduction of knowledge, and provide opportunities for investment in renewal process, the national enterprises will not only maintain the level of their competitive advantage but also increase it.

4. THE LEVELS AND BOUNDARIES OF INNOVATION SYSTEMS

It should be noted that the innovation system can be identified at various levels of the economy, in this regard, innovation systems can be classified into national, regional, sectoral or technological innovation systems. Regardless of level they are all connected with the process of generation, spreading and application of new knowledge. The systems include elements and relations between these elements, and are characterized by certain properties.

The innovation system can be viewed in several dimensions. One of the most important aspects is the physical or geographical boundaries of a system. Sometimes the focus is placed on a particular country or region, resulting in a determined geographical borders of the system. The innovation system of an industry or technology can also be identified; this process includes the theoretical definition of the boundaries of the innovation system. The process of globalization involves not only the strengthening of linkages between economic systems, but also lead to the complexity of the selection boundaries of an innovation system of specific countries. Therefore, the understanding of the issues associated with identification boundaries of a national innovation system is crucial and requires a specific research of the theoretical and methodological basis of this concept.

Recently there has been a wide-spread occurrence of studies which identify system characteristics of innovation at various levels, including research in the field of regional innovation systems [5], technological systems [3], and also in the field of sectoral innovation systems [2].

These concepts were presented and interpreted as alternatives to the theory of national innovation systems. These studies argue that the most significant interactions in the context of modern innovation tend to cross national boundaries and there is no reason to emphasize a national innovation system as a separate concept. However, from our point of view, the concept of national innovation systems is important at least in the context of the development of state regulation of innovation activity. While there are separate economic systems characterized by political, historical and institutional conditions, as well as a national innovation policy a study of national innovation systems continues to be relevant.

Another important aspect of the study of innovation systems is the time period, i.e. the allocation of the time frames of the studied innovation system. The configuration of the elements of the innovation system and links between them changes over time. The composed model of the system at a particular point in time may differ significantly from another model of the same system in a different time period. Thus, the most important aspects of an innovation system are spatial and temporal properties which should be taken into account in the research of efficiency of national innovation systems and identification of the functions and arguments of innovation development.

Development of a systematic approach to the study of innovation activity was carried out together with the research on the impact of the factor of knowledge and innovation in the economic development [20]. According to Merriam-Webster dictionary a system can be defined as a regularly interacting or interdependent group of elements forming a unified

whole. However, considering the fact that different systems serve different purposes, it is not surprising that there are so many notions of a system. The purpose of the study was to review some of the most important analytical and methodological issues arising from the application of a systematic approach to the analysis of the national innovation system. In the context of this study a system as a whole is a structure consisting of elements that are interconnected with each other. This concept is general and designed for different analytical purposes. A systematic approach to the study of innovation systems implies a clear distinction between a system and an environment. Systems differ in their structure, including the extent of the boundaries, the type and number of system elements, their interconnections and relations between a system and an environment. Innovation system can be defined as a set of institutions and relationships regarding the development, implementation and diffusion of innovation [7]. In the innovation system organizations represent a private firm or firms, departments, governmental and non-governmental organizations, universities, research centers, venture funds, associations, etc. on the other hand innovation system can be seen as a set of economic, legal and social norms and regulatory standards.

The relationship between the components of a system (i.e. between individual actors and institutions) are diverse. Entities can both compete and cooperate with each other in the process of creation and implementation of new technologies and innovation. Institutions may support each other, but they can also be in conflict (rivalry) [8]. In addition to the innovation system there is a certain hierarchy in the institutional structure. Institutions shape the incentives for innovation actors to perform certain actions. The key point here is that the subjects of innovation are embedded in the institutional context. The participants of innovative activity can also change or adapt existing institutions or create new ones. Hence there is a subject-object relationship in the framework of the innovation system [7].

The delimitation of the system primarily depends on the selected concept of a system (i.e. national, regional or sectoral). In this case, the spatial conditions or the boundary of the system should be emphasized, due to the fact that national and regional innovation systems have different set of organizations and institutions, and are characterized by certain territorial range of influence and interaction. Sectoral systems can be described within the boundaries of the industry structure and generally cross geographical boundaries. Technological systems typically cross not only geographical boundaries, but also sectoral boundaries [10]. In the latter case, the process of selection of system boundaries should include consideration of the structure of a particular technology (area of application and a market) [3]. The definition of the system boundaries is the most challenging because different technologies and knowledge areas are closely interrelated resulting in blurred boundaries of innovation systems. The question of how to delimit the innovation system, i.e. to distinguish between the system and its environment, is quite complex. The complexity of the issue is determined by the fact that there is no right or wrong way to discover the limits of a system, it is a theoretical construct and usually is adopted to and described for the purposes of a specific research.

5. CONCLUSION

The main factor of competitiveness of a national economy is the ability of industries to produce innovative products, through the introduction of new knowledge and technologies. Innovation, being both a process and an outcome, is aimed at production or adoption, implementation and exploitation of profitable innovations providing new or updated products, development of new methods of production and implementation of new management systems. The theories currently used to study the processes of formation and development of innovation systems, including the theory of national innovation systems, the

theory of endogenous growth and competitiveness of the national economy, allow to highlight the core elements of the innovation system. First and foremost, it is dynamic capabilities, exerted in the ability of the organization to reconfigure the existing resource base through the generation and modification of knowledge aimed at increasing economic efficiency in the process of continuously changing internal and external conditions. Another essential component of the innovation system is the generation and spreading of new knowledge. Well-developed national innovation system forms the system of interconnection between science, government, industry and society, where economic development is based on innovation and the demand of innovative development stimulates the development of scientific (R&D) activity.

This study defines a national innovation system as a set of organizations operating within a legal and institutional environment and promoting development, spreading and transfer of new knowledge and technology. In compliance with this definition, the aim of a national innovation system can be considered as the creation of favorable conditions for realization of innovation potential of the economy. The criterion of efficiency of a national innovation system (as an environment) is the implementation of the developed technologies and the production of goods and services, with new consumer properties and utility. The functional aspects of the outputs of a national innovation system comprise the process of knowledge generation (number of patents, number of researchers etc.), spreading of new knowledge (cooperation of universities and enterprises, inter alia within clusters, etc.) and its implementation. The inputs of the innovation process include utilized resources and/or the products of another process utilized for transformation within the corresponding innovative process.

ACKNOWLEDGEMENT: *This research was supported by Russian Foundation for Basic Research (RFBR) [Project number: 16-29-12995 "Modelling and forecasting of the dynamics of the innovation potential of the national economy"].*

LITERATURE:

1. Bergek, A., Jacobsson, S., Carlsson, B., Lindmark, S., Rickne, A., 2005. Analyzing the dynamics and functionality of sectoral innovation systems — a manual, report delivered to VINNOVA, 30 March 2005. In: The Proceedings of the DRUID Tenth Anniversary Summer Conference 2005. June 25–27, Copenhagen.
2. Breschi, S., Malerba, F., 1997. Sectoral innovation systems. In: Edquist, C. (Ed.), Systems of Innovation: Technologies, Institutions and Organisations. Pinter, London.
3. Carlsson, B., Jacobsson, S., 1997. Diversity creation and technological systems: a technology policy perspective. In: Edquist, C. (Ed.), Systems of Innovation: Technologies, Institutions and Organisations. Pinter, London.
4. Carlsson, B., Stankiewicz, R., 1995. On the nature. Function and composition of technological systems. In: Carlsson, B. (Ed.), Technological Systems and Economic Performance: The Case of Factory Automation. Kluwer Academic Publishers, Dordrecht, pp. 21–56.
5. Cooke, P., Uranga, M.G., Etxebarria, G., 1997. Regional innovation systems: institutional and organisational dimensions. Research Policy 26, 475–491.
6. Crossan, M. M. and Apaydin, M. (2010), A Multi-Dimensional Framework of Organizational Innovation: A Systematic Review of the Literature. Journal of Management Studies, 47: 1154–1191. doi:10.1111/j.1467-6486.2009.00880.x

7. Edquist, C., Johnson, B., 1997. Institutions and organizations in systems of innovation. In: Edquist, C. (Ed.), Systems of Innovation: Technologies, Institutions and Organizations. Pinter Publishers, London, pp. 41–63.
8. Edquist, C., Lundvall, B.-Å., 1993. Comparing the Danish and Swedish systems of innovation. In: Nelson, R.R. (Ed.), National Innovation Systems: A Comparative Analysis. Oxford University Press, Oxford.
9. Edquit, C. and McKelvey, M. 2000. Systems of Innovation: A Reference Collection. Cheltenham, U.K.: Edward Elgar Publishers
10. Hekkert, M.P., Suurs, R.A.A., Negro, S.O., Smits, R.E.H.M., Kuhlmann, S., 2007. Functions of innovation systems: a new approach for analyzing technological change. Technological Forecasting and Social Change 74, 413–432.
11. Landes D.S. The Wealth and Poverty of Nations: Why Are Some So Rich and Others So Poor. New York: W.W. Norton, 1998. 544 pp.
12. Lundvall, B. A., Johnson, B., Andersen, E. S., & Dalum, B. 2002. National systems of production, innovation and competence building. Research Policy. 31(2): 213-231.
13. Malerba, F., 2002. Sectoral systems of innovation and production. Research Policy 31, 247–264.
14. Maskell, P., 2001. Towards a knowledge-based theory of the geographical cluster. Industrial and Corporate Change 10, 921–943.
15. Nelson, R. R. 1993. National Systems of Innovation: A Comparative Analysis. Oxford, U.K.: Oxford University Press.
16. Nelson, R., Romer P. 1996. Science, Economic Growth, and Public Policy, Challenge. 39, 2, 9-21.
17. Porter, M.E., & Stern, S. (1999). The new challenge to America's prosperity: Findings from the innovation index. Washington, DC: Council on Competitiveness
18. Rappa, M., 1994. Assessing the rate of technological progress using hazard rate models of R&D communities. R&D Manage 24 (2), 183–194.
19. Romer P. M. 1986. Increasing returns and long-term growth. Journal of Political Economy. 94 (5): 1002 - 1037.
20. Romer, P.M., 1993. Implementing a national technology strategy with self-organizing industry investment boards. Brookings Papers on Economic Activity: Microeconomics.
21. Porter, M. E. The Competitive Advantage: Creating and Sustaining Superior Performance. NY: Free Press, 1998 –592 p.
22. Richard R. Nelson, Sidney G. Winter. An Evolutionary Theory of Economic Change / Belknap Press. 1985 – 454 p.

SLOVAK LABOUR MARKET AND ITS SPECIFICS

Roman Klimko
University of Economics in Bratislava, Faculty of National Economy, Dolnozemská 1, 852 35 Bratislava
roman.klimko@euba.sk

Eva Rievajova
University of Economics in Bratislava, Faculty of National Economy, Dolnozemská 1, 852 35 Bratislava
eva.rievajova@euba.sk

ABSTRACT
The labour market is considered one of the most important markets as well as a sensitive and vulnerable aspect of the Slovak economy. A prerequisite for desirable development in the Slovak labour market is the shift in the societal orientation from the use of cheap labour force towards growth in competitiveness based on well-trained human resources. The latest labour market trends are in part the result of cyclical movements and particularly deep economic crisis, but also due to structural and institutional labour market problems affecting economic performance and labour markets efficiency. The crisis has affected the EU not only by the loss of performance, but also by an increase in unemployment and decline in the ability to create new jobs. The system solution of longer deepening imbalance in the labour market implies to draw attention to the essence of the problems. In comparison with other EU countries, Slovakia has a relatively low employment rate, especially for young and older people. There are macroeconomic imbalances that continue to pose a serious problem and highlight the need for decisive, comprehensive and coordinated policy actions. The aim of the paper is to analyse specific issues in the Slovak labour market and to compare the situation in Slovakia with contemporary labour market trends in the European Union.
Keywords: *employment, labour market, Slovakia*

1. INTRODUCTION

It is now possible to observe paradoxical developments in the global economy. On the one hand, the economic crisis has affected the global labour market substantially and thus it has influenced the rise in unemployment in developed countries significantly. On the other hand, the theoretical relationships, such as economic and employment growth are no longer so clear. Moreover, the creation of new jobs is quite slow, which means that unemployment rate remains very high despite the economic recovery. There are economists who state that it is only due to a time lag between economic recovery and restoring growth and job creation. However, on the other side, e.g. Stiglitz and Rogoff argue that there is a structural break in the link between economic growth and employment. The economic cycle is in relation to the crisis beyond the traditional view on the cyclical economic development and it also shows the limits and boundaries of use as liberal and Keynesian approaches (Staněk, 2011).

In the Slovak labour market as well as in the labour markets of many EU states can be observed the very same issues, i.e. the employment of low-skilled workers, long-term unemployment and the related loss of skills. Since the late 90s, the EU countries are in tackling labour market imbalances oriented to promote employment growth, what is reflected also in the documents and guidelines for individual Member States, and in approaches to finding common solutions in the area of labour market and employment policy. Therefore, it was adopted the Europe 2020 strategy and the follow-up documents and recommendations focused on growth performance, employment and competitiveness of the Member States. The

European Employment Strategy is in terms of the European Union the main instrument for coordinating the reform efforts of Member States in the labour market. An important EU initiative is the implementation of a uniform EU action to promote employment of vulnerable groups. In addition, as highlighted in Cazes et al. (2009), OECD (2010) and Köttl et al. (2011), if we can talk about economic recovery in the post-crisis period, unfavourable developments in employment will persist for some time.
The aim of the paper is to analyse specific issues in the Slovak labour market and to compare the situation in Slovakia with contemporary labour market trends in the European Union. We use a systematic approach in order to explain relationships and linkages in research problems. The sequence and content of individual parts we chose to meet the objectives of the paper.

2. EUROPEAN UNION AND THE EUROPE 2020 EMPLOYMENT TARGET

Since 2004 (the biggest enlargement in EU history), the EU and the Slovak economy have passed through dynamic development that led to the global financial and economic crisis starting in 2008. The consequences of the crisis have been reflected particularly in economic downturn, the debt crisis in a number of European countries, not excluding Slovakia, and in negative impacts on the euro stability and employment.
According to the World Bank Annual Report 2010, during the economic crises there are challenges for the governments to restore economic growth, to cope with fiscal consolidation, to increase productivity and to create new jobs. The latest labour market trends are in part the result of cyclical movements and particularly deep economic crisis, but also due to structural and institutional labour market problems affecting economic performance and labour markets efficiency. The crisis has affected the EU not only by the loss of performance, but also by an increase in unemployment and decline in the ability to create new jobs. The main consequences of the economic crisis in the global labour market are as follows (Košta, 2011):

- There is an extreme acceleration in regrouping labour needs in IT;
- The manufacturing sector can restore its production capacity to pre-crisis levels even with fewer workers;
- A permanent continuous growth proved to be too optimistic and a previous increase in the number of workers led to a much higher release of workers;
- Technological factor fundamentally shifted again the differences between the jobs creation and jobs destruction.

The employment can be characterized by employment rates and their dynamics. These indicators are monitored and in relation to overall employment, as well as partial, binding to a certain segment of the workforce (for example, the employment rate for men, women, persons over 50 years, youth, etc.). The employment rate in the EU in the last few years has been stagnating and remains below the 75% that is actually the Europe 2020 strategy headline target for the population aged 20-64 years. After a continuous upward trend in the years from 2000 to 2008, when the EU employment rate increased from 66.6% to 70.3%, the employment rate fell in the EU in 2009 to 68.9% as a result of a deep downturn. In 2010 the employment rate declined further to 68.5% and was stable at this level. In 2012 it reached 68% and the target of achieving 75% was quite far away (difference 7 pp). Despite the shared commitment of 75% for the whole EU in average, each Member State has got its own target for employment rate by 2020, specifically in the National Reform Programme. In 2014, the majority of Member States was far away from fulfilment of Europe 2020 strategy employment targets. The employment targets set by Member States are ranging from 59% in

Croatia and 62.9% in Malta to 80% in Denmark and in the Netherlands, and "well over" 80% in Sweden. Some countries such as Cyprus, Ireland, Austria and Italy have set a target range rather than exact levels, and the UK has set no national target (Rievajová et al., 2015). Sweden and Germany reported in 2014 the employment rate 80% and 77.7% respectively and thus nowadays fulfil the employment targets for 2020. The biggest differences between the rates in 2014 and national targets for the Europe 2020 show Spain, Greece, Bulgaria and Hungary, with a difference of over 10 pp. This raises doubts about the ability of particular Member States to meet their targets by 2020. Regarding progress made, Germany and Austria appear to be most successful countries in the fields of employment rate and growth. On the opposite side of the spectrum are Greece, Spain, Croatia, and Italy, which were affected by sharp declines in employment and in comparison with other Member States still have low employment rates (Figure 1).

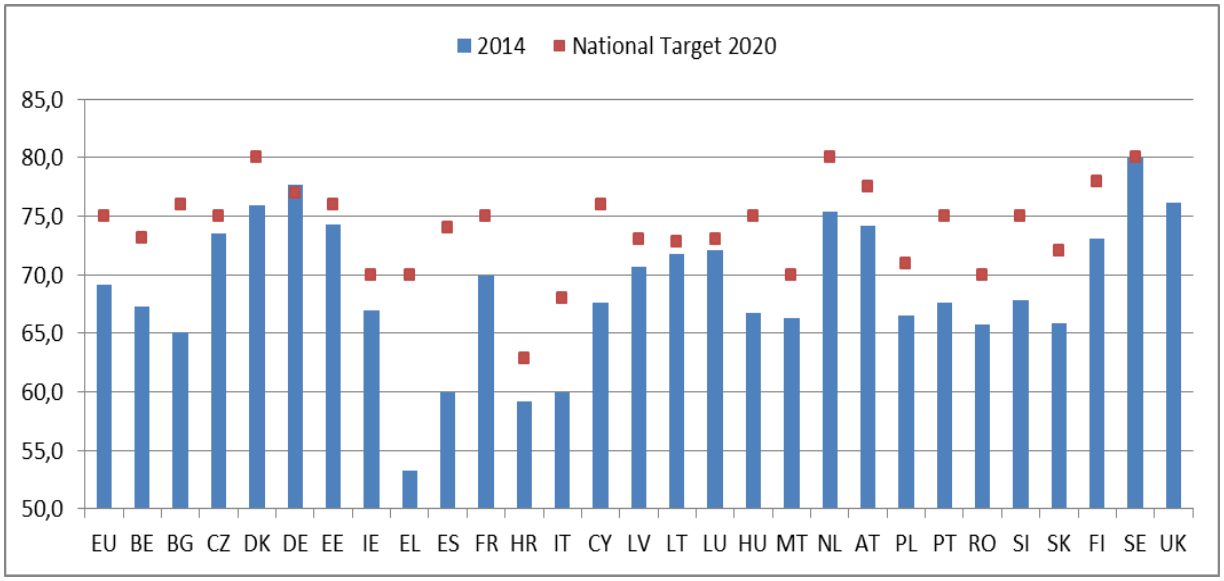


Figure 1. Employment rate in the EU Member States (in %), age group 20-64 years (Eurostat)

Notes: United Kingdom has no target. Sweden - well over 80%, Ireland - 69-71%, Italy - 67-69%, Cyprus - 75-77%, Austria - 77-78%).

Also in the process of economic recovery is the job creation slower than in the pre-crisis period as a result of the decline and stagnation of domestic consumption. There is the time delay between the economic growth and decrease in unemployment (European Commission, 2014c). This situation is caused by a combination of impact of the global crisis and also it takes some time to see some improvements in the labour markets, plus slow pace of labour market reforms in certain Member States. Taking into account that in 2014 was the average employment rate in the EU 69.2%, between 2015 and 2020 it will require a total growth of 5.8 pp what is really only at the level of theory and only approaching the level of 75% will require extraordinary efforts from the position of several Member States. The current strength of economic growth is still insufficient for job creation that we have seen in times before the crisis (NBS, 2013). In the coming years it can be expected that in the medium term, several trends will lead to further job growth, particularly in some areas. For example, technological progress will contribute to the job creation in the ICT sector (till the end of 2015 it was expected 900,000 unfilled professional jobs in the ICT sector), while population ageing despite current limitations on public healthcare budgets is likely to increase in the medium term demand for health professionals and health services (already in 2012 the total number of

persons employed in the health sector in the EU amounted to almost one million). In addition, the greening of the economy may lead to an increase in green jobs. Also the other sectors related to high technology, for example transport industry will require new manpower with medium to high skills, taking into account that it is expected that a high percentage of older workers in the transport sector will leave it by 2020 (European Commission, 2014c) .

3. SELECTED ISSUES OF THE SLOVAK LABOUR MARKET

In terms of the Slovak labour market the favourable trend comparable to the period before the financial crisis was observed in the last quarter 2014 and first quarter 2015 (for the first time since the onset of the crisis). Moreover, the average employment rate increased considerably compared to 2013 (Tab. 1). This is primarily due to a number of the Commission's recommendations, job creation in the automotive industry, government measures of a socio-economic nature to motivate unemployed people to accept jobs (such concurrence of income from employment and social assistance benefits, raising the minimum wage, etc.).

Table 1: Employment rate development in EU and Slovak Republic (in %), age group 20-64 years (Eurostat)

Country/Year	2008	2009	2010	2011	2012	2013	2014
European Union	70.3	68.9	68.6	68.6	68.4	68.4	69.2
Slovak Republic	68.8	66.4	64.6	65.0	65.1	65.0	65.9

Experience from the past tell us that the indicator of unemployment should be seen in a broader context, because in order to evaluate labour market performance it is necessary to examine not only the unemployment rate, but also its structure in terms of duration, sex, education, regional differences, etc. There is an obvious difference between Slovakia and the EU average in terms of unemployment rate in the age group 15-24 years (Košta et al., 2011). Macroeconomic patterns show that unemployment fluctuates depending on the stage of the economic cycle - during a recession or depression increases, in the period of expansion the unemployment rate shrinks. Regarding global recession it is necessary to conclude that thanks to partial reforms in the labour and product markets, the most EU countries recorded moderate unemployment growth only - for the long-term and structural unemployed, compared to previous crises in the past century (Tvrdoň & Tuleja & Verner, 2012).

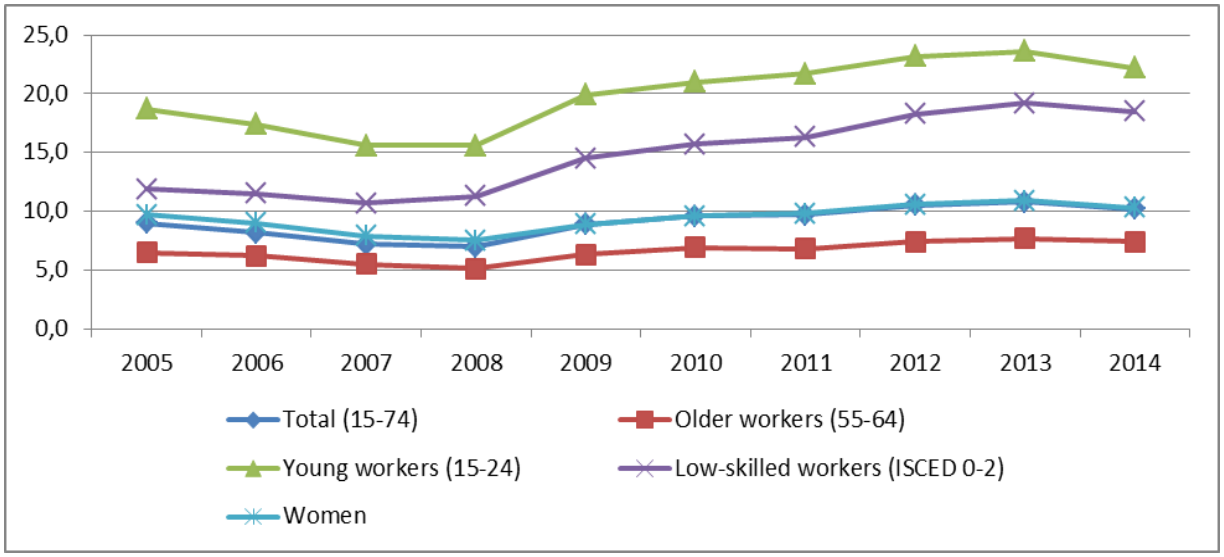


Figure 2: Unemployment rate in the EU since 2005 – overall, young people, older workers and low-skilled workers (Eurostat)

Long-term unemployment remains in most EU countries a serious socio-economic problem as a result of long-term nature of the crisis. Since 2008, the number of long-term unemployed has roughly doubled, while there was an increase in almost all Member States except Germany and Luxembourg. Nowadays, one of the most serious problems is high proportion of young people who have difficulties finding a suitable job (Rievajová et al., 2015). Youth unemployment peaked at 23.6% in the first quarter of 2013 and subsequently at the end of 2014 decreased to 23.1%; it means 5.6 million jobless young people (Figure 2). Almost two thirds of Member States had youth unemployment rates in December 2014 still close to historic highs, with rates up to levels of 40% or above in the countries most affected by the crisis (Greece, Spain, Croatia, Italy, Cyprus and Portugal). During the year 2013, the share of young people who are neither employed, nor in education or training significantly increased in almost half the Member States. Therefore, in the current state there is an urgent need for all Member States to pay more attention to this vulnerable group of unemployed. The EU unemployment rate stopped growing in the middle of 2013. Since the beginning of 2013 the unemployment rate has remained relatively stable. Regarding the year-on-year change in unemployment between 2013 and 2014, there is an obvious positive trend across the majority of Member States (Table 2). The lowest unemployment figures for the last period showed: Austria, Germany, Luxembourg and Malta, the highest Greece and Spain.

Table 2: Unemployment rate development in the EU in % (Eurostat)

	2010	2011	2012	2013	2014
European Union	9.6	9.7	10.5	10.9	10.2
Belgium	8.3	7.2	7.6	8.4	8.5
Bulgaria	10.3	11.3	12.3	13.0	11.4
Czech Republic	7.3	6.7	7.0	7.0	6.1
Denmark	7.5	7.6	7.5	7.0	6.6
Germany	7.0	5.8	5.4	5.2	5.0
Estonia	16.7	12.3	10.0	8.6	7.4
Ireland	13.9	14.7	14.7	13.1	11.3
Greece	12.7	17.9	24.5	27.5	26.5
Spain	19.9	21.4	24.8	26.1	24.5
France	9.3	9.2	9.8	10.3	10.3
Croatia	11.7	13.7	16.0	17.3	17.3
Italy	8.4	8.4	10.7	12.1	12.7
Cyprus	6.3	7.9	11.9	15.9	16.1
Latvia	19.5	16.2	15.0	11.9	10.8
Lithuania	17.8	15.4	13.4	11.8	10.7
Luxembourg	4.6	4.8	5.1	5.9	5.9
Hungary	11.2	11.0	11.0	10.2	7.7
Malta	6.9	6.4	6.3	6.4	5.9
Netherlands	5.0	5.0	5.8	7.3	7.4
Austria	4.8	4.6	4.9	5.4	5.6
Poland	9.7	9.7	10.1	10.3	9.0
Portugal	12.0	12.9	15.8	16.4	14.1
Romania	7.0	7.2	6.8	7.1	6.8
Slovenia	7.3	8.2	8.9	10.1	9.7
Slovakia	14.5	13.7	14.0	14.2	13.2
Finland	8.4	7.8	7.7	8.2	8.7
Sweden	8.6	7.8	8.0	8.0	7.9
United Kingdom	7.8	8.1	7.9	7.6	6.1

In the years before the onset of the crisis in Slovakia there was a positive development of unemployment, when Slovakia approached the EU average. The main factor of higher labour market performance was notably higher rate of economic growth, inflows of FDI, higher household consumption, economic growth in countries of major export partners, measures to improve the functioning of the Public Employment Services, tightening conditions for receiving benefits, as well as changes in tax policy (reduction of income tax) (Tvrdoň & Tuleja and Verner, 2012). After the onset of the crisis in Slovakia, there was a sharp increase in unemployment, cyclical and structural, linked to problems in many export-oriented sectors of the economy. During the crisis, the unemployment rate in Slovakia was sixth highest among the EU countries (Table 2), and finally in 2014 the unemployment rate fell below 14%, with optimistic expectations for the coming years (Table 3). Despite recent improvement, the labour market is one of the main long-term problems of the Slovak economy. In comparison with other EU countries, Slovakia has a relatively low employment and high level of long term unemployment. More than two thirds unemployed are long-term unemployed and this is the greatest challenge to solve in the Slovak labour market, besides employability of people with low education, Roma population and women (NPR, 2015). The unemployment situation is complicated not only because of a small number of jobs created but also their structure is worrying.

Table 3: Unemployment rate in the Slovak Republic in % (Inštitút finančnej politiky, 2015)

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
16.4	13.5	11.2	9.6	12.1	14.5	13.7	14.0	14.2	13.2	12.1	11.3	10.5	9.7

Note: 2015-2018 is forecast.

The segmentation of the labour market in Slovakia remains robust. Since 2011, the share of temporary employees has increased by 0.4 pp, largely reflecting the uncertain economic situation. This contributes to the existing high unemployment and/or low levels of participation of certain groups in the labour market. The overwhelming majority part-time workers are women. The rate of part-time working among women was 32%, compared with 8.4% for men. For comparison, in the Netherlands, the UK, Germany, Austria and Belgium, more than 40% of women working part-time and that significantly reduce employment rates measured in full-time equivalents. The current temporary contracts and contracts for part-time workers, although they are somewhat involuntary, may contribute to job creation and from the mid- to long-term perspective can be a stepping stone to permanent contracts and/or full-time contracts (e.g. the case of young people).

Long and persistent negative developments in the labour markets and worsening the social situation of the population may have a negative impact on potential GDP growth in different ways and on the risk of worsening macroeconomic imbalances (European Commission, 2014a). Decline in the effectiveness of reconciliation of labour supply and demand, and thus caused high unemployment in the EU requires public employment services interventions and active labour market policies. However, the need for fiscal consolidation in many EU countries does not allow increasing the amount of funds spent on active labour market policies. Therefore, there is a greater focus on increasing the efficiency of existing instruments. Available data from Eurostat testify to the fact that spending on active labour market policy in recent years mirrored the level of unemployment. The crisis has clearly shown that social policy must reflect the parameters of employment policy; on the other hand, for instance, the demographic challenge needs to be tackled because it has led to a noticeable increase in financial costs. Hence the willingness to propose further measures which might serve to stimulate employment (e.g. public projects) is much less than before.

4. CONCLUSION

Employment in any economy is closely linked to the dynamics of the economy, its performance and competitiveness. There is some progress in the employment growth since 2011, however, the job losses since 2008 have been far greater and the differences between Member States have been further widened. In comparison with other EU countries, Slovakia has a relatively low employment rate, especially for young and older people. There are macroeconomic imbalances that continue to pose a serious problem and highlight the need for decisive, comprehensive and coordinated policy actions.

Implementation of structural reforms in the labour market must be a priority in dealing with employment growth. It also may have a beneficial impact on productivity growth, competitiveness and investments. For instance, the required structural reforms are: removing barriers to job creation, a reduction in labour taxation for low-skilled workers, and reducing labour market segmentation. Strengthening job growth requires employment policies that create favourable conditions for job creation, increase support for labour demand, improve geographical distribution of labour force, and matching skills and labour market needs. EU funds play an important role in promoting employment growth and balancing regional disparities.

Over the past two decades many countries have established or strengthened policies to activate unemployed with efforts to enhance their employment prospects, which has contributed to better employment results in European labour markets. These measures are aimed at improving labour market functioning, in particular by helping to match unemployed people with available jobs and increase their employability with regard to their future employment. A key principle is precisely the one that employment is preferred over unemployment and these policies should strive to mobilize re-integration of unemployed, whether directly or indirectly through upskilling and training, rather than be just passive recipients of state benefits (Eurofound, 2010).

In order to cope with the challenge of growth effectively, the structural, fiscal and monetary policies have to combine an integrated approach to promote growth, meanwhile, is necessary to implement measures on the demand and supply side. This requires action at all government levels, from the global level, particularly in the context of the G20, to the EU, national, regional and local level. A prerequisite for desirable development in the Slovak labour market is the shift in the societal orientation from the use of cheap labour force towards growth in competitiveness based on well-trained human resources. The system solution of longer deepening imbalance in the labour market implies to draw attention to the essence of the problems - mutually overlapping causes of high unemployment that can be considered in particular: the lack of ability of economic entities to generate productive jobs, significantly limited motivation of some groups to be legally employed, low flexibility and labour mobility, persistent deformation and rigidity of the labour market, improving the framework conditions for business investments, and to improve the quality and volume of investments in research and innovations.

ACKNOWLEDGEMENT: *The paper is the outcome of scientific project VEGA No. 1/0001/16 'Súčasnosť a perspektívy zmien zamestnanosti a súvisiacich procesov v kontexte napĺňania cieľov Európskej stratégie zamestnanosti'.*

LITERATURE:

1. Cazes, S. et al. (2009). *Labour market policies in times of crisis.* Geneva: ILO, 39 p.
2. Eurofound (2010). Financing and operating active labour market programmes during the crisis. Dublin: Eurofound, 19 p. Retrieved 25.03.2017 from http://www.eurofound.europa.eu/pubdocs/2010/66/en/1/EF1066EN.pdf.

3. European Commission (2014a). *Alert Mechanism Report 2015.* Brussels, COM (2014) 904 final. Retrieved 25.03.2017 from http://ec.europa.eu/europe2020/pdf/2015/amr2015_en.pdf.
4. European Commission (2014b). *Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth.* Brussels, COM (2014) 130 final/2. Retrieved 25.03.2017 from http://ec.europa.eu/europe2020/pdf/europe2020stocktaking_en.pdf.
5. European Commission (2014c). *Draft Joint Employment Report from the Commission and the Council accompanying the Communication from the Commission on the Annual Growth Survey 2015.* Brussels, COM (2014) 906 final. Retrieved 21.03.2017 from http://ec.europa.eu/europe2020/pdf/2015/jer2015_en.pdf.
6. Inštitút finančnej politiky (2015). *Makroekonomická prognóza*. Retrieved 19.03.2017 from http://www.finance.gov.sk/Components/CategoryDocuments/s_Load Document.aspx?categoryId=10219&documentId=13287.
7. Košta, J. et al. (2011). *Aktuálne problémy trhu práce v Slovenskej republike po vstupe do Európskej menovej únie.* Bratislava: EÚ SAV, 282 p.
8. Köttl, J. et al. (2011). *Employment Recovery in Europe and Central Asia. The World Bank ECA Knowledge Brief Special Issue No.1.* Retrieved 16.03.2017 from http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2011/06/22/000386194_20110622032401/Rendered/PDF/627390BRI0ECA000box361491B00PUBLIC0.pdf.
9. *National Reform Programme of the Slovak Republic 2015* (NRP) (2015). Retrieved 25.03.2017 from http://ec.europa.eu/europe2020/pdf/csr2015/nrp2015_slovakia_en.pdf.
10. National Bank of Slovakia (NBS) (2013). *Analýza konvergencie slovenskej ekonomiky 2013.* Retrieved 24.03.2017 from http://www.nbs.sk/_img/Documents/PUBLIK/protected/PP_01_2013_Lalinsky_Analyza_konvergencie_slovenskej_ekonomiky_2013.pdf.
11. OECD (2010). *OECD Economic Surveys: Slovak Republic*. November 2010. OECD, 15 p. Retrieved 12.03.2017 from http://www.oecd.org/dataoecd/4/8/46478358.pdf.
12. Rievajová, E. et al. (2015). *Trh práce - premeny a výzvy.* Bratislava: Vydavateľstvo EKONÓM, 253 p.
13. Staněk, P. (2011). *Nové paradigmy sociálnej politiky v globalizovanej ekonomike.* Bratislava: Vydavateľstvo EKONÓM, 102 p.
14. Tvrdoň, M, Tuleja, P., Verner, T. (2012). *Ekonomická výkonnost a trh práce v kontextu ekonomické krize: zkušenosti ze zemí Visegradské čtyřky.* Ekonomie a management, 15(3), 16-31.

NATURAL RESOURCES, GLOBALIZATION AND SUSTAINABLE ECONOMIC WELFARE: A PANEL ARDL APPROACH

Jose Alberto Fuinhas
NECE-UBI, Management and Economics Department
University of Beira Interior
Rua Marquês d'Ávila e Bolama, 6201-001, Portugal

Antonio Cardoso Marques
NECE-UBI, Management and Economics Department
University of Beira Interior
Rua Marquês d'Ávila e Bolama, 6201-001, Portugal

Samuel da Silva Faria
Management and Economics department
University of Beira Interior
Estrada do Sineiro, 6200-209 Covilhã, Portugal

ABSTRACT

Gross Domestic Product (GDP) has been the most widely accepted measure of economic performance, but it fails to accurately measure economic development, overlooking key aspects of quality of life and sustainability. Over the last few years, concern about the future of our planet and sustainability of human activity rose among public eye and political institutions, due to the increased natural resources exploitation, and the intensification and deepening of globalization. Thereby, the Index of Sustainable Economic Welfare (ISEW) emerges as the dominant alternative. This paper aims to: (i) compare both GDP and ISEW as measures of economic performance; and (ii) establish the effects of natural resources exploitation, and globalization on both economic growth and sustainable development. The research question is: Are globalization and natural resources exploitation harmful to economic development? Diagnostic tests show presence of cross-section dependence, heteroskedasticity and serial correlation. Thus, Driscoll-Kraay estimator is performed due to its robustness in the presence of these phenomena. A Panel Autoregressive Distributed Lag approach is used, which allows to check for short and long-term effects of the variables. The panel is composed by 14 OECD countries, and uses annual data for the time span from 1995 to 2013. Results show that natural resource rents have a positive effect on GDP per capita in the short-run and a negative effect on ISEW per capita both on short- and long-run. These results, reveals that enhancing GDP does not account for the impacts of changes in natural capital and that natural resource exploitation may represent a hazard to sustainable development. Trade openness has a positive impact on short-term economic growth and a negative impact on long-term sustainable development. Other results show that social globalization has a positive impact on long-term economic growth and that political integration is positive for economic welfare. Policy makers ought to consider ISEW as an alternative and more accurate measure of economic development, should implement policies that reduce the depletion of natural resources, and confine the harmful effects of globalization to enhance economic development and create more welfare.

Keywords: *Economic Development; Globalization; ISEW; ARDL*

1. INTRODUCTION

Over the last decades, concerns about the future of our planet and sustainability of human activity rose among public eye, academics and political institutions. Recently, the UN established the Sustainable Development Goals (SDG) targeting to improve living standards and well-being of populations and reverse the trend of environmental degradation (UNDP, 2016). Sustainable development may be defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (UNWCED, 1987). Gross Domestic Product (GDP) has been the most widely accepted measure of economic performance, despite its inadequacy on measuring economic welfare (Costanza *et al.*, 2009; Khan *et al.*, 2016; Kuznets, 1934), since it does not distinguish welfare improving activities from welfare reducing activities (Cobb *et al.*, 1995). Thereby, to achieve sustainable development, there is a need to go beyond GDP towards a broader measure that accounts for changes in natural, social and human capital, and therefore welfare and sustainability (Costanza *et al.*, 2009; European Commission, 2011; Kubiszewski *et al.*, 2013). Thus, the Index of Sustainable Economic Welfare (ISEW) emerges as the dominant alternative (Beça & Santos, 2014). The ISEW, originally developed by Daly and Cobb (1994), serves a better purpose on measuring welfare and sustainability than GDP, since it considers the economy within a larger dimension, where social, natural and human capital become part of the same system. Starting with private consumption, it deducts the effects of income inequality, environmental degradation and other expenses that do not generate welfare, the so-called defensive costs (Stockhammer *et al.*, 1997). One advantage of the ISEW compared to other welfare indicators is the monetization of the items, which measure the welfare impacts of past and current activities and allows for a direct comparison between ISEW and GDP. With a broader measure of economic performance, policy makers can shift their actions to achieve general welfare and ensure the sustainability of human activity. Natural resources exploitation has been increasing over the last decades and this intensification is expected to continue in the future (UNEP, 2011), enhancing the need to develop policies that ensure resource efficiency and a more sustainable resource management. Although developed countries with good institutional quality are more likely to have positive effects of natural resources on economic growth (Horváth & Zeynalov, 2014), the question about the welfare and long-run sustainability of natural resources exploitation remains unanswered. Globalization is a process of economic, social and political integration that has been deepened worldwide over the last decades and usually identified as a positive driver to economic development. Since globalization is wider, multi-dimensional phenomena, this process requires analysis from a broader scope, considering its different dimensions may affect economic performance in different ways (Dreher, 2006). Having this, the ISEW allows capturing the effects of those dimensions, examining the consequences of globalization on long-run welfare. This paper aims to: (i) compare both GDP and ISEW as measures of economic performance, and (ii) establish the effects of natural resources exploitation and globalization on both economic growth and sustainable development. The research question is: Are globalization and natural resources exploitation harmful to economic development?

The remainder of this paper is displayed as follows: Section 2 contains the existent literature; Section 3 presents the ISEW; Section 4 describes data and methods; Section 5 presents the results, which are discussed in section 6 and in section 7 final conclusions are stated.

2. LITERATURE REVIEW

2.1 Measuring sustainable development

Gross Domestic Product is the most widely accepted measure of economic performance and has been used to measure both economic growth and economic development. GDP serves a good purpose to measure the market output of an economy, since it measures the flow of

goods and services produced within a period of time. It is composed by private consumption, government expenditure, capital formation and net value of exports. Achieving GDP growth has become the main goal for policy makers since its popularity rose in the aftermath of World War II. Back then, accounting for the intensity of investment, through gross capital formation and government expenditure was a good insight for the pace of countries reconstruction and capacity of production. Private consumption gave good insights about population's income and future expectations and the net value of exports was important to ensure countries economic stability and international position. Altogether, GDP growth was important to measure capacity of production and guarantee political stability. However, GDP was never designed to measure economic welfare or sustainability (Costanza *et al.*, 2009; Kuznets, 1934) since it does not account for changes in the natural, human and social capital which are inherent parts of the economic system. (Costanza *et al.*, 2009; Saunoris & Sheridan, 2013).

Ecological economists consider that GDP is no longer a good indicator of human progress. The baseline for that belief is the so-called threshold hypothesis (Max-Neef, 1995), stating that economic growth causes improvements in the quality of life up to a certain point, beyond which its benefits are exceeded by its costs, deteriorating quality of life and welfare. Thus, alternative indicators have been developed, such as the Index of Sustainable Economic Welfare (ISEW) (Daly *et al.*, 1994) and the Genuine Progress Indicator (GPI) (Cobb), aiming to replace GDP and GDP growth as measures of sustainable economic development.

The ISEW/GPI follow Fisher's (1906) concept of physical income, distinguishing the flow of goods and services from the stock of capital it derives from. Therefore, the main difference between GDP and the ISEW/GPI methodology is the fact while the former treats all flows as income, the latter distinguish welfare generating activities from welfare reducing activities (Cobb *et al.*, 1995). By accounting for these defensive costs, the ISEW/GPI methodology attends to measure sustainable economic welfare rather than economic activity alone (Costanza *et al.*, 2009).

2.1.1 The index of sustainable economic welfare

The ISEW is a broader measure of economic performance that is composed by economic, environmental and social components. Usually, the ISEW calculation starts with a private consumption base, weighted for the distribution of income. Then, the defensive costs are subtracted, accounting for those parts of production that are not disposable for consumption but are required to maintain current levels of consumption and for future losses caused by today's production (Beça & Santos, 2010; Stockhammer et al., 1997). While this approach is well stablished within the ISEW literature, the items that compose the defensive costs are not consensual, specially the social components.

Some authors developed the ISEW for specific countries, adapting the methodology for the country under analysis. For example, the Thailand ISEW (Clarke & Islam, 2005), accounts for the cost of commercial sex work. The Greek ISEW (Menegaki & Tsagarakis, 2015) accounts for the cost of noise pollution, adapting the calculation to the Greek case. Depending on data availability, some authors include items such as the cost of crime, cost of commuting or the cost of family breakdown (Beça & Santos, 2014; Castañeda, 1999; Gigliarano, Balducci, Ciommi, & Chelli, 2014; Jackson, 1996). On one hand, accounting for these disservices improve the theoretical validity of the ISEW, since it includes a wider range of components that may affect welfare and sustainability (Beça & Santos, 2010; Lawn, 2003). On the other hand, it stunts country-wide comparability and raise arbitrary issues. The lack of a standardization of the ISEW methodology remains as one of the main barriers to its development as a policy relevant indicator (Hák et al., 2016; Neumayer, 2000).

In this paper, we focus on building an ISEW that could directly compare to GDP as a macroeconomic indicator. Thus, the ISEW is calculated considering data availability and comparability, comprising the existing framework.

As in Table 1, the first component of the ISEW is the private consumption base, weighted for losses from income inequality. The underneath assumption is that as income inequality rises, overall welfare decreases, since an additional amount of money benefits more a poor family than a richer one (Bleys, 2008).

The contribution of domestic and volunteer labor is then added, which allows to measure non-market production. By valuing the inputs of unpaid work by the average wage, this item is priced by the opportunity costs (Stockhammer et al., 1997). This method enhances the contributes of household and volunteer work to economic welfare.

The ISEW relies on the concept of physic income. Net capital growth measures changes in the stock of capital. Therefore, it measures only the flows of capital and not the stock that it derives from.

Public expenditures on health and education are not always welfare enhancing. Daly and Cobb (1994) state that some of those expenses are defensive, not intended to increase welfare but to repair damages caused by the system, and to prevent the deterioration of human capital.

As in most of the literature (Castañeda, 1999; Gaspar et al., 2017; Gigliarano et al., 2014; Jackson, 1996; Menegaki & Tsagarakis, 2015; Menegaki & Tugcu, 2017), only half of public expenditure on health and education are considered as non-defensive.

The environmental components are forest, mineral and energy depletion which are considered to measure the costs of environmental degradation. The main assumption underneath these defensive costs is that the depletion of natural resources reduces the future stock of this capital.

Carbon dioxide damage cost intends to value the long-term environmental damage from today's structure of production and it is used as in Gaspar et al. (2017) and Menegaki (2016).

To avoid ambiguity, the indicators used in this ISEW are all from World Bank and OECD databases apart from Gini Index, taken from SWIID 5.1 (Solt, 2009, 2016), which favors country-wide comparability and brings more reliability to the indicator.

The formal proposition of the ISEW, as in Marques et al. (2016), Menegaki and Tsagarakis (2015) and Menegaki and Tugcu (2017) is:

Equation 1. Formulation of the ISEW

$$ISEW = Cw + S + Geh + Kn - Ns - Cs$$

Where Cw stands for the Adjusted private consumption expenditures; S is the benefits of unpaid household and volunteer work; Geh represents non-defensive public expenditures, namely education and Health; Kn is the net capital growth; N stands for the depletion of natural capital and Cs is the social defensive costs, which were not computed due to lack of available data.

Table following on the next page

Table 1. Construction of the ISEW

Component	***Source***	***Computation***
Adjusted private consumption (+)	*Final household consumption expenditure – WDI* *Net Gini Index – SWIID 5.1*	*Final household consumption expenditure * (1 – Net Gini Index). Net Gini is Gini post taxes and transfers, accounting for income distributional policies. A 0 value represents perfect equality and 1 perfect inequality.*
Unpaid Work (+)	*Number of unpaid workers – WDI* *Average wage – OECD*	*Number of unpaid workers * Average wage*
Net capital growth (+/-)	*WDI*	*Gross Capital Formation – Gross Capital Consumption*
Non-Defensive Health Expenditure (+)	*WDI*	*Public health expenditure * 0.5*
Non-Defensive Education Expenditure (+)	*WDI*	*Public education expenditure * 0.5*
Mineral Depletion (-)	*WDI*	*Ratio of the value of the stock of mineral resources to the remaining lifetime (capped at 25 years)*
Forest Depletion (-)	*WDI*	*Calculated as the product of unit resource rents and the excess of round wood harvest over natural growth*
Energy Depletion (-)	*WDI*	*Ratio of the value of the stock of energy resources to the remaining lifetime reserves (capped at 25 years)*
Carbon Dioxide Damage (-)	*WDI*	*Carbon dioxide damage is estimated to be $20 per ton of carbon times the number of tons of carbon emitted*

2.2. Natural resources

The relationship between natural resources and economic activity has been emphasized by researchers. There is little consensus on how natural resources exploitation affect long-term economic development. While some authors state that natural resources can boost the economy, others found negative impacts on economic growth. The former part of the literature usually defends the benefits of natural resources as higher stocks of natural capital enhance economic growth. For example, Brunnschweiler and Bulte (2008) separate natural resource dependence from natural resource abundance, therefore separating flows from stocks and conclude that while dependence does not affect economic growth, abundance is growth-enhancing.

On the other hand, some authors found the so-called resource (Ozturk, 2010; Sachs & Warner, 1995). The presence of low institutional quality or rent-seeking competition are usually some of the explanations for this stream of the literature (Parcero & Papyrakis, 2016; Torvik, 2002). In fact, having high quality institutions can help avoiding the resource curse (Havranek, Horvath, & Zeynalov, 2016).

Natural resources abundance may also be correlated with greater levels of income inequality, since the distribution of natural capital tends to be more unequal distributed than physical or human capital (Gylfason & Zoega, 2002). Parcero and Papyrakis (2016) state that in the case of oil, this happens for extreme cases of oil abundance.

Despite there is no consensus on how natural resources affect the economy, particularly in the long-run, using a measure of economic performance which accounts for income inequality or institutional quality may offer broader comprehension of this relationship. Thus, using the ISEW instead of GDP may result in very different results.

2.3 Globalization

Globalization is a continuous and multi-dimensional process of integration which gathers economic, social and political relations of country-wide interdependence. It is usually identified as a positive driver to economic development. Thus, some authors have emphasized the effects of globalization to the economy. Main research focus on trade openness or capital flows as proxies for globalization. For example, Dollar and Kraay (2001) found a positive relation between trade flows, FDI and economic growth. Other authors state that trade openness may result in higher levels of income inequality in both developed and developing countries (Beck *et al.*, 1999).

As mentioned above, globalization is wider phenomena. Thus, it requires analysis from a broader scope, considering its different dimensions may affect economic performance in different ways (Dreher, 2006). The ISEW allows capturing the effects of those dimensions, examining the consequences of globalization on long-run welfare.

3. DATA AND METHOD

The main goal of this paper is to analyze both ISEW and GDP as measures of economic performance and to establish the relationship between globalization and natural resources exploitation with these indicators. Therefore, the first step was building an ISEW that can directly compare to GDP. The calculation of the ISEW is detailed in section 2.1.1.

To secure country-wide comparability and overcome one of the main barriers to the development of the ISEW as a relevant indicator, data availability for all the ISEW components and for the other variables that compound this study was the prior criteria to country selection. Accounting for a homogeneous group of countries, with common policies and similar standards of economic development, was also a concern, avoiding disparities within the ISEW components. Thus, a group of 14 high-developed OECD members was selected, namely Australia, Austria, Canada, Denmark, Finland, Germany, Ireland, Korea, Netherlands, Norway, Spain, Sweden, United Kingdom and United States. Using annual data, the time span from 1995 to 2013, which was the largest available for all the variables in study. All econometric techniques and estimations were performed using software Stata 13.0 and Eviews 9.0.

Regarding the first part of this paper, Fig.1 shows the evolution of the mean values for both GDP and ISEW per capita. The gap between both indicators is notable. While mean GDP per capita rose from 36330 USD in 1995 to 48503 USD in 2013, the mean ISEW per capita was almost stagnant, rising from 19849 USD to just 24764 USD over the same period. Although the panel is composed by high-income developed countries, the gap shows that increased economic growth is not reflected in sustainable economic welfare, which supports the idea of a threshold hypothesis. Different trends between both indicators also shows the inefficiency of GDP to measure sustainable economic welfare, consistent with (Costanza *et al.*, 2009).

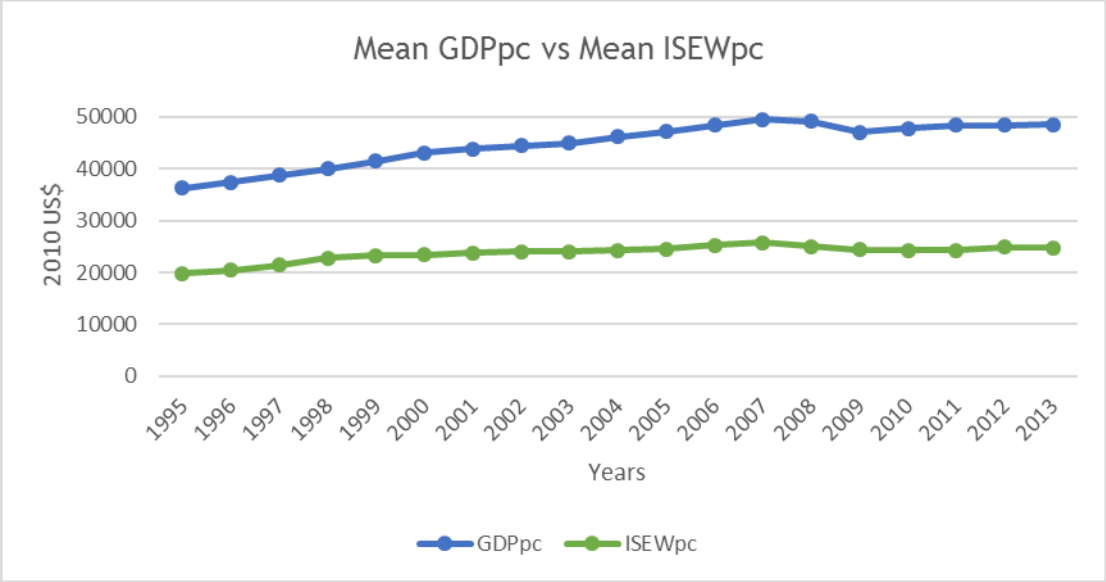


Fig.1. Comparisson between mean values for GDP and ISEW per capita. Values in 2010 US$

The second part of this paper focus on analyzing the effects of globalization and natural resources exploitation on both economic growth (GDPpc) and sustainable economic welfare (ISEWpc). The other variables included in this study are:

- Employment rate (TXEMP) as a proxy for labor. A higher employment rate results in higher disposable income. Therefore, a positive relationship with both GDP and ISEW per capita is expected.

- The Consumer Price Index (CPI) to account for the effects of inflation. CPI may have a negative effect on economic growth, particularly in developed countries, with better institutions. (Ibarra & Trupkin, 2016; Marques *et al.*, 2016).

- Life expectancy at birth (LIFEEXP), to account for the effects of health on human capital. A positive relationship with both ISEW and GDP is expected (Frugoli *et al.*, 2015; Were, 2015).

- Trade Openness (OPENNESS). Trade openness is the part of economic activity resulting from international trade. It is composed by the sum of all imports and exports divided by total GDP.

- Natural Resources Rents per capita (RENTSPC). Obtained by dividing the total natural resource rents by total population, it is included to capture the effects of natural resource abundance/dependence. A positive relationship with GDP is expected due to the financial benefits of natural resources exploitation. On the other hand, a negative relationship with the ISEW is expected, due to the depletion of natural capital.

- The KOF Index of Globalization (Dreher, 2006; Dreher & Dreher, 2016) is included to assess the impacts of globalization. The main advantage of this index is the detachment of the three dimensions of globalization. Therefore, economic (EKOF), social (SKOF) and political (PKOF) dimensions are included in this paper.

Two models were performed. One with economic growth (GDP per capita), and the other one with the sustainable economic welfare proxy (ISEW per capita) as dependent variables. An Autoregressive distributed lad (ARDL) approach was used to breakdown both short- and long-run dynamics. An ARDL model permits to decompose the variables into its short- and long-run effects. The most fitted estimator was selected after the specification tests.

Table 2. Descriptive Statistics and Cross-section dependence (CD) tests.[1]

Variable	***Descriptive statistics***					***Cross section dependence (CD)***		
	Obs	***Mean***	***Std. Dev.***	***Min.***	***Max.***	***CD-test***	***Corr***	***Abs(corr)***
LISEWPC	*266*	*10.04865*	*0.2347551*	*9.148762*	*10.58951*	*24.62****	*0.592*	*0.641*
LGDPPC	*266*	*10.65327*	*0.351088*	*9.410764*	*11.42436*	*39.37****	*0.947*	*0.947*
LTXEMP	*266*	*4.532221*	*0.0441222*	*4.300003*	*4.584968*	*10.86****	*0.261*	*0.432*
LCPI	*266*	*4.81274*	*0.1266583*	*4.097372*	*4.702087*	*41.00****	*0.986*	*0.986*
LLIFEEXP	*266*	*4.369325*	*0.226005*	*4.295847*	*4.419781*	*41.03****	*0.987*	*0.987*
LRENTSPC	*266*	*5.260411*	*2.000246*	*0.5259663*	*9.273802*	*27.84****	*0.670*	*0.670*
LOPENNESS	*266*	*4.245564*	*0.4517299*	*3.097822*	*9.273802*	*19.70****	*0.474*	*0.619*
LEKOF	*266*	*4.365814*	*0.1604767*	*3.817314*	*4.59667*	*20.63****	*0.496*	*0.553*
LSKOF	*266*	*4.396134*	*0.1356682*	*3.849704*	*4.527115*	*33.04****	*0.795*	*0.795*
LPKOF	*266*	*4.488122*	*0.1071728*	*4.024765*	*4.575573*	*8.47****	*0.204*	*0.398*

[1] CD test was performed with the Stata routine xtcd and has N(0,1) distribution. Null hypothesis is cross-section independence. *** denotes significance at 1% level.

Table 2 displays the descriptive statistics and cross section dependence (CD) tests for all variables. Cross-section dependence is identified as a problem in macro panel data. Thus, Pesaran (2004) CD test was performed and suggest the presence of cross-section dependence. This means that the countries share common developments for all variables, consistent with the fact the panel is composed by high-income OECD members and have common policies and similar living standards.

To check for multicollinearity, the Variance Inflation Factor (VIF) test was computed (Table 3). The low values for the VIF statistics states that for these variables, multicollinearity is far from being a concern.

Table 3. Variance Inflator Factor (VIF) statistics[2]

Variable	VIF	1/VIF
LLIFEEXP	*4.06*	*0.246473*
LCPI	*3.72*	*0.268807*
LEKOF	*3.36*	*0.297539*
LSKOF	*3.26*	*0.306592*
LRENTSPC	*2.46*	*0.406453*
LPKOF	*2.28*	*0.437881*
LOPENNESS	*1.38*	*0.723584*
LTXEMP	*1.35*	*0.743470*
Mean VIF	*2.73*	

Good econometric practices recommend testing the adequacy of panel data techniques. The Lagrange Multiplier (LM) test was performed to check the existence of country-specific effects, using both LISEWPC and LGDPPC as dependent variables, which proved the adequacy of panel techniques.

One of the main advantages of the ARDL approach is its robustness in the presence of I(0) or I(1) variables. Thus, to verify the order of integration of the variables, second generation panel unit root tests, namely the CIPS (Pesaran, 2007), were performed (Table 4). This test has the advantage of being robust in the presence of heterogeneity. Some variables can be identified as I(0), like LRENTSPC and LPKOF and LISEWPC, LTXEMP, LCPI. LEKOF and LLIFEEXP are I(1) or borderline I(1)/I(0). None of the variables is I(2), so the ARDL approach can be pursued.

Table 4. Panel Unit Root Test (CIPS)[3]
(Ends on the next page)

Variables	***2nd generation Unit Root Test***	
	CIPS (Zt-bar)	
	No trend	***With trend***
LISEWPC	*0.162*	*-1.126*
LTXEMP	*1.462*	*1.856*
LCPI	*2.476*	*4.926*
LRENTSPC	*3.291***	*-1.468**
LOPENNESS	*0.586*	*1.689*
LEKOF	*-1.442**	*-1.623**
LSKOF	*-1.361**	*-3.079****
LPKOF	*-5.200****	*-3.138****
LLIFEEXP	*-1.125*	*0.6511*

[2] By rule of thumb, 10 takes on as critical value for the presence of multicollinearity.

[3] Table 4 – Pesaran (2007) Panel Unit Root test (CIPS). Null hypothesis: series are I(1). The Stata routine multipurt was used to compute the test. ***, **, * denote significance at 1%, 5% and 10% levels, respectively.

LGDPPC	*2.082*	*0.795*
DLISEWPC	*-7.117****	*-5.274****
DLTXEMP	*-2.584****	*-0.581*
DLCPI	*-2.103***	*-1.396**
DLRENTSPC	*-10.979****	*-9.118****
DLOPENNESS	*-5.301****	*-4.585****
DLEKOF	*-8.859****	*-7.491****
DLSKOF	*-9.986****	*-8.780****
DLPKOF	*-10.864****	*-9.682****
DLLIFEEXP	*-6.197****	*-5.452****
DLGDPPC	*-4.169****	*-2.759****

Following the outcomes of the unit root test, Westerlund (2007) test of co-integration was performed (Table 5), to check for co-integration among variables. To achieve robust results, bootstrapping is recommended. Thus, 500 reps were used. The presence of co-integration is strongly rejected, whether considering the panel as a whole (Pt and Pa tests) or considering each country individually (Gt and Ga tests).

Table 5. Westerlund Tests of Co-integration.[4]

Statistic	***Value***	***Z-value***	***P-value***	***Robust P-value***
Gt	*-1.418*	*4.821*	*1.000*	*0.862*
Ga	*-3.172*	*5.357*	*1.000*	*0.774*
Pt	*-3.064*	*5.379*	*1.000*	*0.912*
Pa	*-2.433*	*3.988*	*1.000*	*0.750*

4. RESULTS AND DISCUSSION

A series of tests were carried out to ascertain the validity of the estimations. First, the panel Lagrange Multiplier (LM) test was performed, with the null-hypothesis being rejected in both models (X^2= 850.74*** with LISEWPC as dependent variable and 1010.99*** with LGDPPC), which supports the usage of panel data techniques.

A common characteristic in macro panels is heterogeneity. Thus, to cast for the most suitable panel estimator, the adequacy of the Mean Group (MG), Pooled Mean Group (PMG) or Dynamic Fixed Effects (DFE) ought to be tested. The models were estimated and then, the Hausman test was performed (Table 6).

Table 6. Hausman Tests[5]

Sustainable Development (LISEWPC) Models		***Economic Growth (LGDPPC) Models***	
MG vs PMG	*MG vs DFE*	*MG vs PMG*	*MG vs DFE*
*60.19****	*0.00*	*37.45****	*0.00*

The outcomes points DFE as the most suitable estimators. The DFE models implies homogeneity for all coefficients, and therefore, the panel is homogeneous, with similar behaviors. This is consistent with the fact the panel share common policies.

Considering this, specification tests were performed to check for heteroskedasticity and serial correlation in both models (Table 7).

[4] Table 5- Westerlund (2007) Tests of Co-integration. Null hypothesis: no co-integration. Gt and Ga test: co-integration for each country individually. Pt and Pa test: co-integration for the panel as a whole. Stata routine xtwest was used to compute the test.

[5] Table 6- Hausman test. Null hypothesis: differences in coefficients are not systematic. The stata routine xtpmg was used to compute the models. *** denotes significance at 1% level.

Table 7. Specification tests[6]

Specification tests	***Sustainable Development DFE Model***	***Economic Growth DFE Model***
Walt test	*819.74****	*176.73****
Woolridge test	*106.248****	*47.946****

Considering the presence of cross-section dependence among variables and heteroskedasticity and first order autocorrelation in the DFE models, the Driscoll and Kraay (1998) estimator was used. This estimator is robust in the presence of this phenomena. In the economic growth models, the variable LLIFEEXP was not statistically significant and was removed to improve the statistical quality of the models.

Table 8. Estimation results[7]

	Sustainable Development Models		***Economic Growth Models***	
Variable	***DK***	***DK'***	***DK***	***DK'***
DLTXEMP	*1.9061354****	*1.997944****	*1.2102577****	*1.1515259****
DLCPI	*0.30367919*		*-0.32552446***	*-0.38299278****
DLRENTSPC	*-0.02613914****	*-0.02303236***	*0.01091384***	*0.01056886***
DLOPENNESS	*-0.00261013*		*0.04813924**	*0.06714717***
DLEKOF	*0.11561274*	*0.13279185**	*0.08699618**	
DLSKOF	*0.00848524*		*0.12030184****	*0.10070603***
DLPKOF	*0.2866746***	*0.2961854****	*-0.02242092*	
DLLIFEEXP	*0.08646579*		----------	----------
LISEWPC (-1)	*-0.37872085****	*-0.35523408****	----------	----------
LGDPPC (-1)	----------	----------	*-0.16156352****	*-0.12139148****
LTXEMP (-1)	*0.77864243****	*0.79025483****	*0.19053171****	*0.16840149****
LCPI (-1)	*-0.05613363*		*0.0548831*	
LRENTSPC (-1)	*-0.01791549***	*-0.01623466***	*-0.00024654*	
LOPENNESS (-1)	*-0.0010344***	*-0.00080196***	*-0.00023305**	
LEKOF (-1)	*-0.009578*		*0.03787333**	
LSKOF (-1)	*0.10712815*		*0.19427705****	*0.16307074****
LPKOF (-1)	*-0.0285898*		*-0.05926945****	*-0.03894993****
LIFEEXP (-1)	*1.8494311***	*1.4233225***	----------	----------
_CONS	*-7.6742801****	*-6.0720824***	*-0.10152289*	*0.00991053*
Statistics				
N	*252*	*252*	*252*	*252*
R^2	*0.4882*	*0.4823*	*0.7248*	*0.709*
F	*F(17,13)=2896.83****	*F(9,13)=402.02****	*F(15,13)=410.68****	*F(9,13)=196.1****

Table 8 presents the Driscroll and Kraay estimations. For both models, the estimation was computed with all variables at first. Variables that were not statistically significant were then removed. DK' denotes final estimations with only significant variables.
Considering the outcomes of table 8, short-run elasticities are presented in table 9. The long-run elasticities/impacts were computed. For sustainable development model (SD), the elasticities were obtained, dividing the coefficients of each variable by the coefficient of LISEWPC, lagged once and the total value divided by -1. For the economic growth model (EG), the same process was carried out, but dividing by the coefficient of LGDPPC.

[6] Table 7- Modified Wald test. Null hypothesis: Homoscedasticity. In Woolridge test, the null hypothesis is no serial correlation. *** denotes significance at 1% level.
[7] Table 8- Estimation results. ***, **, * denote statistical significance at 1%, 5% and 10% levels, respectively. Stata routine xtscc was used to compute the estimations.

Table 9. Elasticities/impacts and adjustment speed[8]

Sustainable Development Model (DK')		***Economic Growth Model (DK')***	
Short-run elasticities/impacts			
DLTXEMP	*1.997944****	*DLTXEMP*	*1.1515259****
DLRENTSPC	*-0.02303236***	*DLCPI*	*-0.38299278****
DLEKOF	*0.13279185**	*DLRENTSPC*	*0.01056886***
DLPKOF	*0.2961854****	*DLOPENNESS*	*0.06714717***
		DLPKOF	*0.10070603***
Computed long-run elasticities/impacts			
LTXEMP	*0.79025483****	*LTXEMP*	*0.16840149****
LRENTSPC	*-0.01623466***	*LSKOF*	*0.16307074****
LOPENNESS	*-0.00080196***	*LPKOF*	*-0.03894993****
LLIFEEXP	*1.4233225***		
Speed of adjustment			
ECM	*-0.35523408****	*ECM*	*-0.12139148****

As expected, in both models, the employment rate has a positive impact on both short- and long-run, and significant at 1% level. Having a higher employment rate means higher disposable income. Despite the differences of the measures, labor is found to be a positive input for both sustainable development and economic growth. Life expectancy at birth has also a positive long-run impact on SD model. This means that for sustainable development, health is a positive driver in the long-run. These variables hence the importance of human capital to economic performance.

The negative impact of inflation on short-run economic growth is justified by the composition of the panel, namely OECD high-developed countries. As mentioned in section 3, inflation may have negative effects on economic growth, especially in high-developed, near steady-state countries (Ibarra & Trupkin, 2016).

Accounting for the changes in natural capital is the main difference between the ISEW and GDP methodologies (Kubiszewski *et al.*, 2013). Thus, as expected, natural resource rents per capita has a positive impact on short-run economic growth and negative impacts on both short- and long-run on sustainable development. These different impacts hence the argument that GDP only considers the financial benefits of resource abundance. The degradation of natural capital, through resource depletion and the environmental costs of resource exploitation exceeds the benefits it generates to sustainable economic welfare (Costanza *et al.*, 2009; Gaspar *et al.*, 2017).

The relationship between globalization and both SD and EG was studied by the inclusion of trade openness and the KOF Index of Globalization (Dreher, 2006). While the former intends to state the importance of the international trade flows to the economy, the latter is an indicator which considers the economic, political and social dimensions of globalization. Considering this, trade openness (LOPENNESS) has a positive impact on short-run EG and a negative impact on long-run SD. The positive impact on economic growth is explained through the direct financial benefits of international trade to domestic demand. On the other hand, trade openness may increase income inequality (Beck *et al.*, 1999; Dollar & Kraay, 2001), and therefore have a negative impact long-run economic welfare.

Considering the composition of the KOF Index, political globalization is measured with items such as embassies in the country, membership in international organizations, or participation in UN security council missions.

[8] Elasticities/impacts and adjustment speed. ***, **, * denotes significance at 1%, 5% and 10% levels. ECM refers to the coefficient of LISEWPC(-1) in SD model and LGDPPC(-1) in EG model.

This may explain the positive impact on short-run SD, since the international position of a country is usually used in ISEW methodology (Beça & Santos, 2010) as a positive welfare driver. On the other hand, considering the panel is composed by politically integrated countries (OECD members), in long-run, the costs of additional international presence do not contribute to increase economic growth.
Social globalization is identified with a positive long-run impact on economic growth, which hence the long-run contributions of social proximity between countries as well as the social development.

5. CONCLUSIONS AND POLICY IMPLICATIONS

This paper intended to compare both ISEW and GDP as measures of economic performance and to establish the effects of natural resources exploitation and globalization on both indicators. Panel data techniques were applied, namely DFE and DK estimators, to a panel composed by 14 OECD high-developed countries.
Considering the first part of the paper, the ISEW is an indicator which compounds economic, social and environmental items, accounting for changes in natural, social and human capital. The focus was on building an ISEW which allowed to country-wide comparability, and therefore, to overcome some critiques to the ISEW methodology, namely, the lack of a standardized methodology and ambiguity on its components (Neumayer, 2000). Thus, the ISEW was computed using established framework (Gaspar *et al.*, 2017; Marques *et al.*, 2016; Menegaki & Tugcu, 2016, 2017). The gap between both indicators (Fig.1) hences the differences when measuring sustainable development vs economic growth.
Regarding to the second part of this paper, the focus was on to directly compare the short- and long-run effects of natural resources exploitation and globalization on both indicators. While some of the variables show similar impacts on both SD and EG, namely the employment rate and short- run political globalization, the different impacts of some variables reveal the differences between both indicators. While natural resource rents per capita has a positive impact on GDP per capita in the short-run, a negative impact is found in ISEW per capita in both short- and long-run. These results demonstrate that enhancing GDP does not account for the impacts of changes in natural capital and that natural resource exploitation may represent a hazard to sustainable development.
The usage of KOF Index permits to capture the effects of different dimensions of globalization. GDP per capita brings together, in a better way, the impacts of the KOF components, which may state that the items that compose the index are not perfectly accurate to measure long-run sustainable development. Trade openness may have a long-run on ISEW per capita, due to increased income inequality. Other results show that political globalization may boost both EG and SD in the short-run, and that social globalization has a positive impact on long-run economic growth.
This paper contributes to the establishment of the ISEW as a standardized economic indicator. Future research on this topic would benefit from accounting for the social costs in the ISEW framework which would permit a deepening of the ISEW concept into a better measure of economic performance. This would require a better statistical report from all countries, making it possible to compare social costs country-wide.
Despite the actual limitations, policy makers ought to consider the ISEW as an alternative and more accurate measure of economic development, should implement policies that reduce the depletion of natural resources to guarantee the sustainability of human activity, and confine the harmful effects of globalization to enhance economic development and create more welfare.

LITERATURE:

1.Beça, P., & Santos, R. (2010). Measuring sustainable welfare: A new approach to the ISEW. *Ecological Economics*, *69*(4), 810–819. https://doi.org/10.1016/j.ecolecon.2009.11.031
2.Beça, P., & Santos, R. (2014). A comparison between GDP and ISEW in decoupling analysis. *Ecological Indicators*, *46*, 167–176. https://doi.org/10.1016/j.ecolind.2014.06.010
3.Beck, T., Demirgüç-kunt, A., Levine, R., Demirguc-Kunt, A., & Levine, R. (1999). A New Database on Financial Development and Structure. *The World Bank Economic Review*, *14*(3), 597–605. https://doi.org/10.1093/wber/14.3.597
4.Bleys, B. (2008). Proposed changes to the Index of Sustainable Economic Welfare: An application to Belgium. *Ecological Economics*, *64*(4), 741–751. https://doi.org/10.1016/j.ecolecon.2007.10.013
5.Brunnschweiler, C. N., & Bulte, E. H. (2008). The resource curse revisited and revised: A tale of paradoxes and red herrings. *Journal of Environmental Economics and Management*, *55*(3), 248–264. https://doi.org/10.1016/j.jeem.2007.08.004
6.Castañeda, B. E. (1999). An index of sustainable economic welfare (ISEW) for Chile. *Ecological Economics*, *28*(2), 231–244. https://doi.org/10.1016/S0921-8009(98)00037-8
7.Clarke, M., & Islam, S. M. N. (2005). Diminishing and negative welfare returns of economic growth: An index of sustainable economic welfare (ISEW) for Thailand. *Ecological Economics*, *54*(1), 81–93. https://doi.org/10.1016/j.ecolecon.2004.10.003
8.Cobb, C., Halstead, T., & Rowe, J. (1995). If the GDP is Up , Why is America Down ? *The Atlantic*, *267*(4), 50–78.
9.Costanza, R., Hart, M., Posner, S., & Talberth, J. (2009). Beyond GDP : The Need for New Measures of Progress Beyond GDP : The Need for New Measures of Progress. *Boston University*, (4), 1–47. https://doi.org/0109 970401
10.Daly, H., Cobb, J., & Cobb, C. (1994). *For the Common Good: Redirecting the Economy Toward Community, the Environment and a Sustainable Future*.
11.Dollar, D., & Kraay, A. (2001). Trade , Growth , and Poverty. *Social Science Research Network*, *38*(3), 16–20. https://doi.org/10.1111/j.0013-0133.2004.00186.x
12.Dreher, A. (2006). Does Globalization Affect Growth? Evidence from a New Index of Globalization. *Applied Economics*, *38*(6), 1091–1110. https://doi.org/10.1080/00036840500392078
13.Dreher, A., & Dreher, A. (2016). Does globalization affect growth ? Evidence from a new index of globalization Does globalization affect growth ? Evidence from a new index of globalization, *6846*(March). https://doi.org/10.1080/00036840500392078
14.Driscoll, J. C., & Kraay, A. C. (1998). Consistent covariance matrix estimation with spatially dependent panel data. *Review of Economics & Statistics*, *80*(4), 549–560. https://doi.org/10.1162/003465398557825
15.European Commission. (2011). EC COMMUNICATION: Roadmap to a Resource Efficient Europe. *European Commission*, 32. https://doi.org/COM(2011) 571 final
16.Fisher, I. (1906). *The Nature of Capital and Income*. Kelley, New York, NY.
17.Frugoli, P. A., Almeida, C. M. V. B., Agostinho, F., Giannetti, B. F., & Huisingh, D. (2015). Can measures of well-being and progress help societies to achieve sustainable development? *Journal of Cleaner Production*, *90*, 370–380. https://doi.org/10.1016/j.jclepro.2014.11.076
18.Gaspar, J. dos S., Marques, A. C., & Fuinhas, J. A. (2017). The traditional energy-growth nexus: A comparison between sustainable development and economic growth approaches. *Ecological Indicators*, *75*, 286–296. https://doi.org/10.1016/j.ecolind.2016.12.048
19.Gigliarano, C., Balducci, F., Ciommi, M., & Chelli, F. (2014). Going regional: An index of sustainable economic welfare for Italy. *Computers, Environment and Urban Systems*, *45*,

63–77. https://doi.org/10.1016/j.compenvurbsys.2014.02.007
20.Gylfason, T., & Zoega, G. (2002). Inequality and Economic Growth: Do Natural Resources Matter? *CESifo GmbH, CESifo Working Paper Series: CESifo Working Paper No.712, 2002*, (March). Retrieved from http://search.proquest.com/docview/56669804?accountid=17248
21.Hák, T., Janoušková, S., & Moldan, B. (2016). Sustainable Development Goals: A need for relevant indicators. *Ecological Indicators*, *60*, 565–573. https://doi.org/10.1016/j.ecolind.2015.08.003
22.Havranek, T., Horvath, R., & Zeynalov, A. (2016). Natural Resources and Economic Growth: A Meta-Analysis. *World Development*, *88*(609642), 134–151. https://doi.org/10.1016/j.worlddev.2016.07.016
23.Horváth, R., & Zeynalov, A. (2014). The Natural Resource Curse in Post-Soviet Countries : The Role of Institutions and Trade Policies. *Working Papers*. Retrieved from https://ideas.repec.org/p/ost/wpaper/341.html#?
24.Ibarra, R., & Trupkin, D. R. (2016). Reexamining the relationship between inflation and growth: Do institutions matter in developing countries? *Economic Modelling*, *52*, 332–351. https://doi.org/10.1016/j.econmod.2015.09.011
25.Jackson. (1996). Sustainable Economic Welfare in Sweden. *Stkckholm Environment Institute*.
26.Khan, S. A. R., Zaman, K., & Zhang, Y. (2016). The relationship between energy-resource depletion, climate change, health resources and the environmental Kuznets curve: Evidence from the panel of selected developed countries. *Renewable and Sustainable Energy Reviews*, *62*, 468–477. https://doi.org/10.1016/j.rser.2016.04.061
27.Kubiszewski, I., Costanza, R., Franco, C., Lawn, P., Talberth, J., Jackson, T., & Aylmer, C. (2013). Beyond GDP: Measuring and achieving global genuine progress. *Ecological Economics*, *93*, 57–68. https://doi.org/10.1016/j.ecolecon.2013.04.019
28.Kuznets, S. (1934). National Income, 1929-1932. In *NBER, National Bureau of Economic Research* (pp. 1–12). Retrieved from http://www.nber.org/chapters/c2258
29.Lawn, P. A. (2003). A theoretical foundation to support the Index of Sustainable Economic Welfare (ISEW), Genuine Progress Indicator (GPI), and other related indexes. *Ecological Economics*, *44*(1), 105–118. https://doi.org/10.1016/S0921-8009(02)00258-6
30.Marques, A. C., Fuinhas, J. A., & Gaspar, J. D. S. (2016). On the Nexus of Energy Use - Economic Development: A Panel Approach. *Energy Procedia*, *106*, 225–234. https://doi.org/10.1016/j.egypro.2016.12.118
31.Max-Neef, M. (1995). Economic growth and quality of life: A threshold hypothesis. *Ecological Economics*, *15*, 115–118. https://doi.org/10.1016/0921-8009(95)00064-X
32.Menegaki, A. N., & Tsagarakis, K. P. (2015). More indebted than we know? Informing fiscal policy with an index of sustainable welfare for Greece. *Ecological Indicators*, *57*, 159–163. https://doi.org/10.1016/j.ecolind.2015.04.037
33.Menegaki, A. N., & Tugcu, C. T. (2016). Rethinking the energy-growth nexus: Proposing an index of sustainable economic welfare for Sub-Saharan Africa. *Energy Research and Social Science*, *17*, 147–159. https://doi.org/10.1016/j.erss.2016.04.009
34.Menegaki, A. N., & Tugcu, C. T. (2017). Energy consumption and Sustainable Economic Welfare in G7 countries; A comparison with the conventional nexus. *Renewable and Sustainable Energy Reviews*, *69*(November 2016), 892–901. https://doi.org/10.1016/j.rser.2016.11.133
35.Neumayer, E. (2000). On the methodology of ISEW, GPI and related measures: Some constructive suggestions and some doubt on the "threshold" hypothesis. *Ecological Economics*, *34*(3), 347–361. https://doi.org/10.1016/S0921-8009(00)00192-0
36.Ozturk, I. (2010). A literature survey on energy-growth nexus. *Energy Policy*, *38*(1), 340–

349. https://doi.org/10.1016/j.enpol.2009.09.024
37.Parcero, O. J., & Papyrakis, E. (2016). Income inequality and the oil resource curse. *Resource and Energy Economics*, *45*, 159–177. https://doi.org/10.1016/j.reseneeco.2016.06.001
38.Pesaran, M. H. (2004). General Diagnostic Tests for Cross Section Dependence in Panels General Diagnostic Tests for Cross Section Dependence in Panels. *SSRN Electronic Journal*, *1229*(August).
39.Pesaran, M. H. (2007). A simple panel unit root test in the presence of cross-section dependence. *Journal of Applied Econometrics*, *22*(2), 265–312. https://doi.org/10.1002/jae.951
40.Sachs, J. D., & Warner, A. M. (1995). Natural Resource Abundance and Economic Growth. *NBER Working Paper*, *No. 5398*.
41.Saunoris, J. W., & Sheridan, B. J. (2013). The dynamics of sectoral electricity demand for a panel of US states: New evidence on the consumption-growth nexus. *Energy Policy*, *61*, 327–336. https://doi.org/10.1016/j.enpol.2013.05.092
42.Solt, F. (2009). Standardizing the World Income Inequality, 1–16.
43.Solt, F. (2016). The Standardized World Income Inequality Database*. *Social Science Quarterly*, *97*(5), 1267–1281. https://doi.org/10.1111/ssqu.12295
44.Stockhammer, E., Hochreiter, H., Obermayr, B., & Steiner, K. (1997). The index of sustainable economic welfare (ISEW) as an alternative to GDP in measuring economic welfare. *Ecological Economics*, *21*, 19–34.
45.Torvik, R. (2002). Natural resources, rent seeking and welfare. *Journal of Development Economics*, *67*(2), 455–470. https://doi.org/10.1016/S0304-3878(01)00195-X
46.UNDP. (2016). *Human Development Report 2016*. *United Nations Development Programme*. https://doi.org/eISBN: 978-92-1-060036-1
47.UNEP. (2011). *Decoupling Natural Resource Use and Environmental Impacts from Economic Growth*. *International Resource Panel*. Retrieved from http://www.unep.org/resourcepanel/decoupling/files/pdf/Decoupling_Report_English.pdf
48.United Nations World Commission on Environment and Development. (1987). Report of the World Commission on Environment and Development : Our Common Future Acronyms and Note on Terminology Chairman â€™ s Foreword, 300.
49.Were, M. (2015). Differential effects of trade on economic growth and investment: A cross-country empirical investigation. *Journal of African Trade*, *2*(1–2), 71–85. https://doi.org/10.1016/j.joat.2015.08.002
50.Westerlund, J. (2007). Testing for Cointegration in Panel Data. *Oxford Bulletin of Economics and Statistics*, *69*(6), 709–748. https://doi.org/10.1111/j.1468-0084.2007.00477.x

THE INDICATORS OF SHARE PRICE VOLATILITY

Branko Soric
The University Department of Professional Studies, Split, Croatia
bsoric@oss.unist.hr

Ivan Peronja
Faculty of Maritime Studies, Split, Croatia
iperonja@pfst.hr

Toni Susak
Faculty of Economics, Split, Croatia
tsusak@efst.hr
The University Department of Professional Studies, Split, Croatia
tsusak@oss.unist.hr

ABSTRACT
Generally, financial analysis implies the usage of information contained in financial statements. It's immanent disadvantage is that aforementioned information are focused on past events and consequentially they have limited predicting ability. Despite that, they are commonly used to calculate financial ratios because of it's informational objectivity and availability. They are regularly used by investors in process of making decision whether to invest or not in a specific share. Every investor seeks risk minimization and return maximization. In that sense, volatility of a share is possible alternative for measuring the risk of investment. The main aim of this paper is to statistically analyse which variables can be considered as reliable predictors of share price volatility. Findings presented in this paper are based on sample of companies which operate in Republic of Croatia. Financial information was obtained from annual financial statements publicly available on Croatian Financial Agency official website while volatility data was gathered from Zagreb Stock Exchange official website.
Keywords: *Share price, Volatility, Determinants, Zagreb Stock Exchange, Croatia.*

1. INTRODUCTION TO RISK AND VOLATILITY OF SHARES

Risk can be defined as uncertainty of future outcome. Market risk or risk of changing the price of securities is, presumably, the most important risk associated with securities. Volatility is an indicator that measures the risk of changing the price of securities. This is an indication of how much the security is subject to price fluctuations. The most common causes of stock price changes are: disharmony of supply and demand on the market, disclosure of company business results, mergers and acquisitions of companies and changes in interest rates (Latković, 2002, p. 465).

2. SOME INDICATORS OF SHARE PRICE VOLATILITY

One of the most common price volatility indicators is the Bollinger Band which comprises three curves – central SMA (Simple Moving Average) and additional (lower and upper) curves which are plotted two standard deviations from SMA. SMA is calculated on the basis of the moving average or the average of the closing prices over a given period of time. The purpose of this indicator is to indicate the signals of end or the beginning of the other trend. The distance between curves represents the degree of volatility. If securities pass through a period of low volatility, the distance between the curves will be reduced. Conversely, if securities pass through a period of high volatility, the distance between the curves will

increase. Standard deviation as a measure of total risk is not of high interest to an investor who owns a portfolio of shares. He is more interested in how much an additional share in portfolio contributes to the overall portfolio risk, which is measured by the Beta coefficient (β) (Bendeković, 2000, pp. 1293). β is a measure which shows the volatility of a portfolio compared to the market. If beta is less than 1 portfolio it is less volatile than the market. If β is higher than 1, portfolio it is more volatile than the market. β coefficients are calculated as historical (ex post) β coefficients, expected (ex ante) β coefficients and expected β coefficients with correction of historical beta.

Cacia and Tzvetkov have analysed two volatility indicators: the VIX (Implied Volatily Index) and the NEVI (Net Emotional Volatility Index) (Cacia & Tzvetkov, 2008). VIX comprises the counter strategy, taking positions contrary to market sentiment while NEVI follows the expectations of the investor. Counter strategy starts from the assumption of behavioral finance that investors often act as flocks and have false estimates. The foundation of each counter strategy is to recognize when most of the participants become too extreme in their optimism or fear. The VIX index is considered by many as a barometer of market sentiment and market volatility (Chicago Board Options Exchange). VIX is the indicator that was first applied on the Chicago Board Options Exchange (CBOE) in 1993. and was originally based on Black-Scholes's pricing model. Investors who blindly follow the VIX indicators will probably be wrong from time to time. The NEVI indicator is a kind of confirmation for investors' feelings. It is calculated as the difference between implied volatility based on the VIX market and predictions based on the model during the same period (GARCH - Generalized Autoregressive Conditionally Heteroscedastic - Econometric Tool for Modeling Time-Changing Conditional Variances).

The GARCH model is a model that the present volatility relates to the volatility of the previous period. The GARCH model as well as the ARCH model are analytical models that are applied in the analysis of time series in which heteroskedasticity is present, that is, when the variances of the errors we make are non-constant, they are changing as t changes. The ARCH model was first introduced by American economist Robert Fry Engle (1982.), while Bollerslev and Taylor published the GARCH model independently of each other in 1986. as a more realistic model than ARCH (Bollerslev, 1986).

Relying on Markowitz's portfolio theory and the Fama's Hypothesis of the Efficient Market, VAR (Value-at-Risk) model was developed in 1996. by the JP Morgan Investment Bank. Using this model, restrictions are imposed on investments that are determined on the basis of the risk of certain investments and their intercorrelations. This diversifies the risk and effectively reduces the capital needed to cover the risky positions (Latković, 2002, p. 472).

3. PREVIOUS RESEARCHES AND HYPOTHESES

3.1. Previous researches

Profilet (2013.) has founded that share price volatility is in negative relationship with leverage and in positive relationship with payout ratio. The analysis conducted by Hussainey et al. (2010.) has proven a significant negative relationship between the the share price volatility and payout ratio and significant positive relationship between price volatility and debt. Razaq et al. (2014.) have examined relationship between share price volatility and dividend payout ratio and founded that it was a weak and positive relationship. Al-Shawawreh (2014.) has analysed relationship between share price volatility and dividend payout. He has founded significant negative relationship between mentioned variables.

Bayo Olaoye et al. (2013.) have founded that share price volatility is in positive relationship with profitability ratio. Kenyoru et al. (2013.) stated that „payout ratio is important determinant and reduces share price volatility".

Table 1. *Some recent researches on effective tax rate determinants*

Financial ratio groups	**Sign**	**Relationship with share price volatility**	
		Positive	**Negative**
Profitability	+	Hussainey et al. (2010.) Bayo Olaoye et al. (2013.)	
Debt	+ / -	Hussainey et al. (2010.) Razaq et al. (2014.)	Profilet (2013.) Nazir et al. (2010.)
Dividend payout	+ / -	Profilet (2013.) Zakaria et al. (2012.)	Hussainey et al. (2010.) Al-Shawawreh (2014.) Kenyoru et al. (2013.) Nazir et al. (2010.)

Source: Authors' creation

Zakaria et al. (2012.) show that there is a significant positive relationship between share price volatility and dividend payout ratio. Nazir et al. (2010.) have founded a negative relationship between the the share price volatility and payout ratio and also debt.

These recent researches imply that, regarding share price volatility, there was positive relationship with profitability, negative relationship with dividend payout and the sign of relationship with debt couldn't be determined using information available from researches.

3.2. Hypotheses

According to theoretical remarks from previous researches, hypotheses are established as following:

Hypothesis 1 – profitability indicator has statistically significant positive relationship with share price volatility.

Hypothesis 2 – debt indicator has statistically significant relationship with share price volatility.

Hypothesis 3 – dividend payout indicator has statistically significant negative relationship with share price volatility.

4. RESEARCH SAMPLE, STATISTICAL METHODOLOGY AND RESEARCH RESULTS

4.1. FINANCIAL RATIOS INCLUDED IN RESEARCH

Following financial ratios were included in statistical analysis in order to determine if there was basis to accept established hypotheses:

Table 2. *Financial ratios included in research*

Abbrev.	Ratio	Formula
ROA	Return on Assets	Net profit / Total Assets
TD/EC	Total Debt to Equity Capital	Total Debt / Equity Capital
DPR	Dividend Payout Ratio	DPS / EPS
DPS	Dividend per Share	Total Dividends for Common Shares / Common Shares
EPS	Earnings per Share	(Net Profit – Preference Share Dividends) / Number of Common Shares

Source: Authors' creation using Belak, V. (2014). Analiza poslovne uspješnosti, *RRiF Plus d.o.o.*, Zagreb

4.2. RESEARCH SAMPLE, STATISTICAL METHODOLOGY AND RESEARCH RESULTS

Sample comprises 50 companies from Republic of Croatia which were quoted on Zagreb Stock Exchange (ZSE) in 2013. Financial data for financial analysis was collected from ZSE official website as well as closing stock market prices for companies included in sample needed for calculation of volatility. Multiple regression (MR) was used as statistical methodology to develop model which will show relationship between share price volatility and independent variables of profitability, debt and dividend payout. Coefficient of Variation was used as relative measure of volatility based on standard deviation.

Table 3. *Correlations and collinearity statistics*

	Correlations			Collinearity Statistics	
	Zero-order	Partial	Part	Tolerance	VIF
(Constant)					
ROA	-0,276	-0,367	-0,294	0,997	1,003
TD/EC	0,580	0,614	0,580	0,993	1,007
DPR	-0,183	-0,171	-0,129	0,993	1,007

Software used in analysis: IBM Corp.: „*IBM SPSS Statistics for Windows*", Version 22.0., Armonk: NY: IBM Corp., 2013.

Table following on the next page

Table 4. implies that there is no multicollinearity problem for all analysed variables.

Table 4. *Multiple regression model summary*

R	R Square	Adjusted R Square	Std. Error of the Estimate
0,665	0,443	0,406	0,0905244

Software used in analysis: IBM Corp.: „*IBM SPSS Statistics for Windows*“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Table 5. *ANOVA table*

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	0,299	3	0,100	12,180	0,0001
Residual	0,377	46	0,008		
Total	0,676	49			

Software used in analysis: IBM Corp.: „*IBM SPSS Statistics for Windows*“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Table 6. *Coefficients*

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0,112	0,014		7,907	0,0001
ROA	-0,025	0,009	-0,295	-2,674	0,010
TD/EC	0,006	0,001	0,582	5,273	0,0001
DPR	-0,048	0,041	-0,130	-1,174	0,246

Software used in analysis: IBM Corp.: „*IBM SPSS Statistics for Windows*“, Version 22.0., Armonk: NY: IBM Corp., 2013.

MR model was formed using fundamental groups of financial analysis (profitability, debt and dividend payout) as variables multiplied by it’s coefficients:

VL = 0,112 – 0,025*ROA + 0,006*TD/EC – 0,048*DPR,

where:

- VL – volatility expressed as CV;
- ROA – return on assets;
- TD/EC – Total Debt to Equity Capital;
- DPR – Dividend Payout Ratio.

Most significant contribution in predicting volatility was made by TD/EC (0,582). ROA and TD/EC make statistically significant contribution to the dependent variable at 1% significance. DPR is not statistically significant at 5%. TD/EC has positive effect on VL while ROA and DPR have negative effect on VL.

4.3. Acceptance of hypotheses

After analysis of statistical findings, the acceptance status of hypotheses is as following:

Table 7. *Status of established hypotheses*

No	Hypothesis	Status
1.	*Hypothesis 1 – profitability indicator has statistically significant positive relationship with share price volatility.*	**REJECTED**
2.	*Hypothesis 2 – debt indicator has statistically significant relationship with share price volatility.*	**ACCEPTED**
3.	*Hypothesis 3 – dividend payout indicator has statistically significant negative relationship with share price volatility.*	**ACCEPTED**

Source: Authors' creation

Results of this research have followed findings in previous researches for TD/EC ratio and DPR, while it haven't for ROA.

5. CONCLUSION

At the same time, investors seek risk minimization and return maximization. In that sense, volatility of a share is one possible alternative for measuring the risk of investment. The main aim of this paper was to generate MR model for predicting volatility of share prices. Three main groups of financial ratios were included – profitability (ROA), debt (TL/E) and dividend payout (DPR). Coefficients have shown following – profitability and dividend payout indicators were in negative relationship with volatility of share, while debt indicators were in positive relationship with volatility of share. It is important to note that hypotheses were established using findings from previous researches.

LITERATURE:

1. Al-Shawawreh, F. K. (2014). The Impact of Dividend Policy on Share Price Volatility: Empirical Evidence from Jordanian Stock Market. *European Journal of Business and Management*, 6(5), 216.
2. Bayo Olaoye, S. & Ifayemi Olayinka, M. & Ayodeji Ajibade, T. & Oluwatosin Akinyemi, D. (2016). Profitability and Stock Price Volatility of Nigerian Listed Manufacturing Companies. *Research Journal of Finance and Accounting*, 7(18), 62.
3. Belak, V. (2014). Analiza poslovne uspješnosti, *RRiF Plus d.o.o.*, Zagreb
4. Bendeković, D. (2000). Pristup procjeni rizika i povrata kod ulaganja u obične dionice, *Ekonomski pregled, 51*.
5. Bollerslev, T. (1986). Generalized Autorregressive Conditional Heteroskedasticity, *Journal of Econometrics*, 31, 307-327.

6. Cacia, F., Tzvetkov, R. (2008). Volatility Based Sentiment Indicators for Timing the Markets, *School of Economics and Management Lund University*
7. Chicago Board Options Exchange, available at: http://www.cboe.com/products/vix-index-volatility/vix-options-and-futures/vix-index
8. Engle, R. (1982). Autorregressive Conditional Heteroskedasticity with Estimates of United Kingdom Inflation, *Econometrica*, 50, str. 987-1008.
9. Hussainey, K., Oscar Mgbame, C., & Chijoke-Mgbame, A. M. (2011). Dividend policy and share price volatility: UK evidence. *The Journal of risk finance*, 12(1), 57-68.
10. Kenyoru, N. D., Kundu, S. A., & Kibiwott, L. P. (2013). Dividend policy and share price volatility in Kenya. *Research journal of finance and accounting*, 4(6), 115-120.
11. Latković, M. (2002). Upravljanje rizicima: identifikacija, mjerenje i kontrola, *Financijska teorija i praksa 26.*
12. Nazir, M. S., Nawaz, M. M., Anwar, W., & Ahmed, F. (2010). Determinants of stock price volatility in karachi stock exchange: The mediating role of corporate dividend policy. *International Research Journal of Finance and Economics*, 55(55), 100-107.
13. Pallant, J. (2007). SPSS Survival Manual, Third Edition, *McGraw-Hill*
14. Profilet, K. A., & Bacon, F. W. (2013). Dividend policy and stock price volatility in the US equity capital market. *ASBBS Proceedings*, 20(1), 219.
15. Razaq, A., Said, M., Almeri, M. O., & Shanikat, M. M. (2014). The Accounting Variables' Ability in Explaining the Volatility of Stock's Price: The Case of Amman Stock Exchange. *European Journal of Business and Management*, 6(38), 133.
16. The Zagreb Stock Exchange, www.zse.hr
17. Zakaria, Z., Muhammad, J., & Zulkifli, A. H. (2012). The impact of dividend policy on the share price volatility: Malaysian construction and material companies. International *Journal of Economics and Management Sciences*, 2(5), 1-8.

ALTERNATIVE AND FLEXIBLE FORMS OF EMPLOYMENT: SITUATION IN CZECH REPUBLIC

Martin Smid
University of Pardubice, Faculty of Economics and Administration, Czech Republic
Martin.Smid@upce.cz

Sabina Navratilova
University of Pardubice, Faculty of Economics and Administration, Czech Republic
st39893@student.upce.cz

ABSTRACT

The paper deals with the legal options of using of alternative and flexible forms of employment in Czech Republic according to the legal frame given mainly by the Labour Code (Act No. 262/2006 Coll.). The theoretical approach in the paper is based on the principle of flexicurity combining the concept of flexibility and the concept of security of employment. The difference between flexibility and liberalization of labour law and the context of Industry 4.0 is also mentioned in the paper. Current situation and evolution of use of these alternative and flexible forms of employment is analysed in the paper; the analysis is focused on part-time jobs. The paper includes comparison of the situation in the neighboring countries (Germany, Austria, Slovakia and Poland). The conclusion is focused on limits of flexibility and liberalization of labour law and summarizes the benefits of alternative and flexible forms of employment and the possibilities of its higher usage in Czech labour law.

Keywords: *Labour law, flexicurity, liberalization, employment*

1. INTRODUCTION

The aim of the paper is to give the laternative and flexible forms of employment in the context of the principle of flexicurity. First, the main terms (flexicurity, flexibility, security, liberalization) are explained; than follows the comparison of situation of use of part-time jobs in Czech Republic and neighbouring countries (Germany, Austria, Slovakia and Poland). One of the important context in which we have to speak about the labour market is the concept of Industry 4.0.

The paper uses the standard methods of legal interpretation and the basic statistical description and analysis of selected data. Based on that, synthesis of acquired knowledge is given in the conclusion.

2. THEORETICAL BACKGROUND – IDEA OF FLEXICURITY

A key concept that can be applied to the issue of alternative forms of employment is the idea of flexicurity (a combination of words of flexibility and security), as shown by the European Green Paper (Green Paper, 2006, pp. 7-14). According to this document, there should be greater job flexibility while maintaining the protection of employees' rights and decent living conditions for employees. The objectives of the Green Paper are above all to identify the key challenges and contexts of adapting labour law to the labour market reality, to involve all participants in an open dialogue on the future of labour law, and to encourage debate on how flexible and reliable contractual relationships can help create jobs and improve the functioning of the labour market.

The term flexicurity first appeared in connection with the labour market in Denmark and the Netherlands. It is used for a model of the labour market that uses a combination of flexibility in content, the creation and termination of a working relationship with the protection of an employee or a person who does not have a job. It combines the liberal form of employment, typical of Anglo-Saxon law, with the protection of income protection typical of continental law, and, finally, intensive measures in active employment policy, common to Scandinavian countries (Hůrka, 2009, p. 24). This model is also referred to as the Danish flexicurity model or the golden triangle (Madsen, 2002, p. 2). Flexicurity is then a way which should lead to a mutual matching of these requirements, even though they may appear contradictory. Flexicurity instruments are primarily labour law, social security law, active employment policy and lifelong learning (Janičová, 2009, p. 188).

2.1. Flexibility

Flexibility as a concept can be understood as freedom, flexibility or mobility. In the context of private law, it is primarily a legal space for the realization of the will of the parties. In this respect, flexibility is closely related to dispositive character of private law, namely that legal regulation of law applies only if agreement of parties on their rights and obligations doesn't say differently. Flexibility necessarily brings a lesser degree of legal regulation, or even the need for deregulation (Štangová, 2014, p. 198).

On the most general level, it is possible to distinguish flexibility of employment and flexibility of work performance. As the flexibility of employment is perceived freedom of choice of the legal relationship in which the parties wish to implement job performance. Concrete examples of this flexibility include: agreements on work performed outside the employment relationship, fixed-term employment, probationary period, agency employment or temporary assignment. The flexibility of work performance means the realization of work in the usual employment relationship, but in a flexible way, taking into account the will of the parties. As examples of the flexibility of work performance we can include: shorter working hours, unequal working hours, overtime, flexible working hours, homeworking and teleworking or job-sharing (Hůrka, 2011, p. 88).

External flexibility will mean flexibility in the creation and termination of the employment relationship, ie from the employer's point of view, the ease of recruitment and dismissal of employees, from the employee's point of view, the easy way to get employment, but also to leave it. Internal flexibility then lies in the ability of both sides to adjust the form of employment according to their ideas, in particular through flexible forms of work (flexibility of working hours and rest periods, places of work, etc.).

Flexibility can also be considered in relation to the other side of the legal relationship, and differentiating between unilateral (subjective) and bilateral (objective) flexibility (Hůrka, 2009, p. 28). Unilateral flexibility makes it possible to establish rights and obligations by expressing the will of one party to the legal relationship, bilateral only by the mutual will of both parties. The full flexibility is especially given in the case of bilateral flexibility; In case of unilateral legal proceedings, flexibility can be discussed only with connection with the termination of employment (possibility to unilaterally terminate the employment relationship), but not with the conditions and content of the employment relationship (Janičová, 2009, p. 193). Cases where the employer can unilaterally adjust the rights or obligations of an employee (internal regulation, working order, wage bill) are not the expression of flexibility in my opinion. On the contrary, it is a restriction on the autonomy of the will due to the application of the employer's superiority and the employee's subordination during the employment relationship (Stránský, 2014, p. 185). Flexibility is typically

associated with alternative forms of employment. Because of the uneven nature of demand for its goods and services, the employer has to find flexible forms of employment, mainly for two reasons: to cover the increased need for labour for a certain period of time, and to have the opportunity of a seamless termination of the employment in a situation where he / she does not have a work for the employee (Olšovská, 2014, p. 155). Flexibility is inherently linked to the liberalization of labour law. If labour law is to be understood as a private law branch, the rights and obligations in labour law should be regulated primarily by the contract. Therefore, issues in labour law shouldn't be solved by the delegation of the possibility of imposing rights and obligations unilaterally to the employer, but leaving the solution to the contract as a crucial institute of private law. Liberalization of labour law should therefore be seen as a process of releasing space for wider use of contractual freedom. From this point of view, liberalization also leads to flexibility, but this will apply, as is clear from the above, only to bilateral flexibility. Flexibility and liberalization should be understood as parallel phenomena that are mutually conditioned (Bělina, 2009, p. 76).

2.2. Security

It is important to bear in mind that, although the need for greater flexibility undoubtedly exists, flexibility also has its limits. The basic limitations limiting the flexibility of legal regulation are fundamental human rights, especially social rights, which represent the basic level of social status of an individual. These rights are guaranteed both by national law and by international law and European Union law (Štangová, 2014, p. 198).

Security can be applied not only to employees who are in some employment relationship, but to the entire labour market. It is an important defining feature of labour law because its role is to limit the unacceptable use of competitive freedom. In the higher sense, therefore, labour law protects human dignity as a value superior to others – eg economic freedoms (Barancová, 2009, p. 23).

The security in labour law is represented mainly by: the protection of the collective rights of employees, the protection of income, the protection of the maintenance of the existing employment relationship, the protection of the labour market end employment, the protection of reproduction of knowledge and skills, and the safety and health protection during work (Hůrka, 2009, p. 25).

In general, this term is inseparably linked to the protective function of labour law, which historically stood for the independence of labour law. The so-called protective legislation has emerged as a set of legal norms to protect employees as the wearer of labour and to prevent its abuse. So even today, the labour law can be defined as protective law (Galvas, 2015, p. 43).

This protection is primarily aimed at protecting minimum standards of working conditions, safeguarding the stability of work engagement and protecting the social sphere of employees. In the framework of flexicurity, attention should be focused primarily on the realization of this protection through state policy and the minimization of the transfer of these obligations and the costs associated with them to the employer.

2.3. Flexicurity

It's not easy to realize the contractual freedom and guarantee the protection of the employee in the same time. In a way, however, the term flexicurity is totally contradictory. Flexibility means the possibility for contractual parties to work relationships to adjust their mutual rights and obligations as freely as possible, with minimal limitations on the part of the legislator,

whether European or national. Social security, on the contrary, means protection of the labour market, protection of working conditions, ie the intervention of the legislator, again either European or national (Bělina, 2014, p. 10).

The solution here is first and foremost a flexible solution to the employment contract and the provision of social security in the first place by the state (and not to transfer this solution to the employer). It therefore consists of a legal regulation which, on the one hand, allows for the free negotiation of the content of the basic labour law relationship according to the parties' ideas, on the other hand, it provides employees with adequate protection and safety in their work. Flexicurity thus directs to the fulfillment of the meaning of labour law. Its purpose is to enable the employer to perform his / her activities through the work done by the employee and, on the other hand, to ensure that the employee has the appropriate working conditions. In order to achieve this, it is desirable to allow the content of the employment relationship to be negotiated in such a way as to match as much as possible the views of the parties and, at the same time, to ensure conditions for work that protect employees and ensure the safety of life and health.

Flexicurity consists primarily of a change in the understanding of employee protection, from providing protection under a particular employment relationship to protecting employment in general. Flexicurity thus allows flexibility in the labour market and the labour-law relationship, and thus the use of the autonomy of the will to create, change or terminate the labour-law relationship. At the same time, it must protect the intake of man (both in the workplace and within the social system) and ensure the functioning of the labour market, in particular through an active employment policy. The level of protection of employees should be such that the legislation still protects the rights and legitimate interests of employees, while not motivating employers to disrespect or circumvent it, because then the legislation would be meaningless (Štangová, 2014, p. 198). The idea of flexicurity can be also connected to the concept of 4th generation of industrial revolution (Industry 4.0) which can lead to need for less number of workers but also for more flexible and skilled workers. Many jobs can be lost in favour of automatization and robotization of working processes (Wolter, 2015). According to some authors, a significant drop in the required workforce over the 10-15 year horizon can be expected (Andrew, 2014).

One of the ways the flexicurity can be used and supported, is the possibility to use some types of alternative employment. These alternative types of employment can be helpful in decreasing unemployment rate and in employing the population groups endangered in the labour market.

3. ALTERNATIVE FORMS OF EMPLOYMENT IN CZECH LABOUR LAW

The Czech Labour Code permits the work to be performed only on the basis of one of the basic labour-law relationships, including employment, work-activity agreement and work-performance agreement. In labour law, there are numerus clausus of contractual types, dependent labour can not be exercised on the basis of a legal relationship other than one of the basic labour relations. Recently, we can see that this adjustment is not satisfactory, but has been criticized earlier. According to some authors, the closed system of contractual types is not sustainable for a long time (Galvas, 1994, p. 10; Dolobáč, 2014, p. 226). According to Helena Barancova, removing this obstacle in the long run has benefited from the extension of the subject of labour law and thus its protection (including the related protection of social security law) to other categories of economically active persons, the nature of whose activity is located between employees and self-employed persons. Examples of such contracts or work can be, for example, management contracts or the activity of professional athletes

(Barancová, 2013, p. 83). However, the question of atypical labour relations is wider than the question of performing work outside the traditional employment relationship. Atypical labour relations can be distinguished from a typical employment relationship on the basis of several criteria, including, in particular, the criterion of employee protection, the criterion of the relationship between the employee and the employer and the criterion of place of work.

These labour relations can therefore be considered atypical in Czech labour law:

(A) employment relationships based on agreements on work done outside the employment relationship (work-activity contract and work-performance contract),

(B) homeworking and teleworking carried out as part of an typical employment relationship,

(C) employment carried for shorter than standard time (part-time job).

(D) agency employment.

All these atypical labour relations are characterized by a higher degree of autonomy of will, which is also associated with a lower level of employee protection. These relationships can thus be seen as more flexible.

4. USE OF PART-TIME EMPLOYMENT IN CZECH REPUBLIC

For further analysis, part-time employment was chosen and we will compare the situation with part-time employment in Czech Republic with situation in other countries. Generally it can be said that the use of alternative (non-traditional) forms of employment in Czech Republic is very low. This applies to comparison mainly to the Western neighbours of Czech Republic, but for our comparison, all neighbouring countries of Czech Republic (Germany, Austria, Poland and Slovakia) were chosen. The number of part-time employees in the Czech Republic shows a value of 4.7 %. Comparison with most of the neighboring states does not get too good. In Germany, the proportion of these employees is 22.4 %, in Austria 21 %, and 6.4 % in Poland and in Slovakia 5,7 % (OECD, 2016). So Czech Republic has lower rate than all of its neighbouring countries.

Part-time jobs are historically more popular in Germany and Austria, as we can see in following table by Eurostat. Also in Poland the number is higher than Czech Republic, but generally the situation in Poland, Czech Republic and Slovakia is similar and significantly worse (from the perspective of use of part-time jobs) than the average of European Union. In Eurostat statistics, the figures of Slovakia are lower than figures of Czech Republic (in OECD statistics it's otherwise).

Table 1: Use of part-time job in selected countries in percentage (Eurostat, 2015)

- *Ends on the next page* -

Year **Country**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Germany	21,7	22,3	24,0	25,8	26,1	25,9	26,1	26,2	26,8	26,8	27,7	27,6
Austria	18,7	19,7	21,3	22,0	22,7	23,5	24,8	25,3	25,3	26,0	26,8	27,9
Poland	10,5	10,8	10,8	9,8	9,2	8,5	8,4	8,4	8,0	7,9	7,8	7,8

Slovakia	2,4	2,7	2,5	2,8	2,6	2,7	3,6	3,9	4,2	4,1	4,8	5,2
Czechia	5,0	4,9	4,9	5,0	5,0	4,9	5,5	5,9	5,5	5,8	6,6	6,4
EU-28	16,5	17,2	17,7	18,0	18,1	18,2	18,7	19,2	19,5	20,0	20,4	20,4

In graphical analysis we can see growth of use of part-time employment in most countries (except Poland). It also can be seen that the linear trend of the development is in most countries almost identical to the actual development of use of part-time jobs.

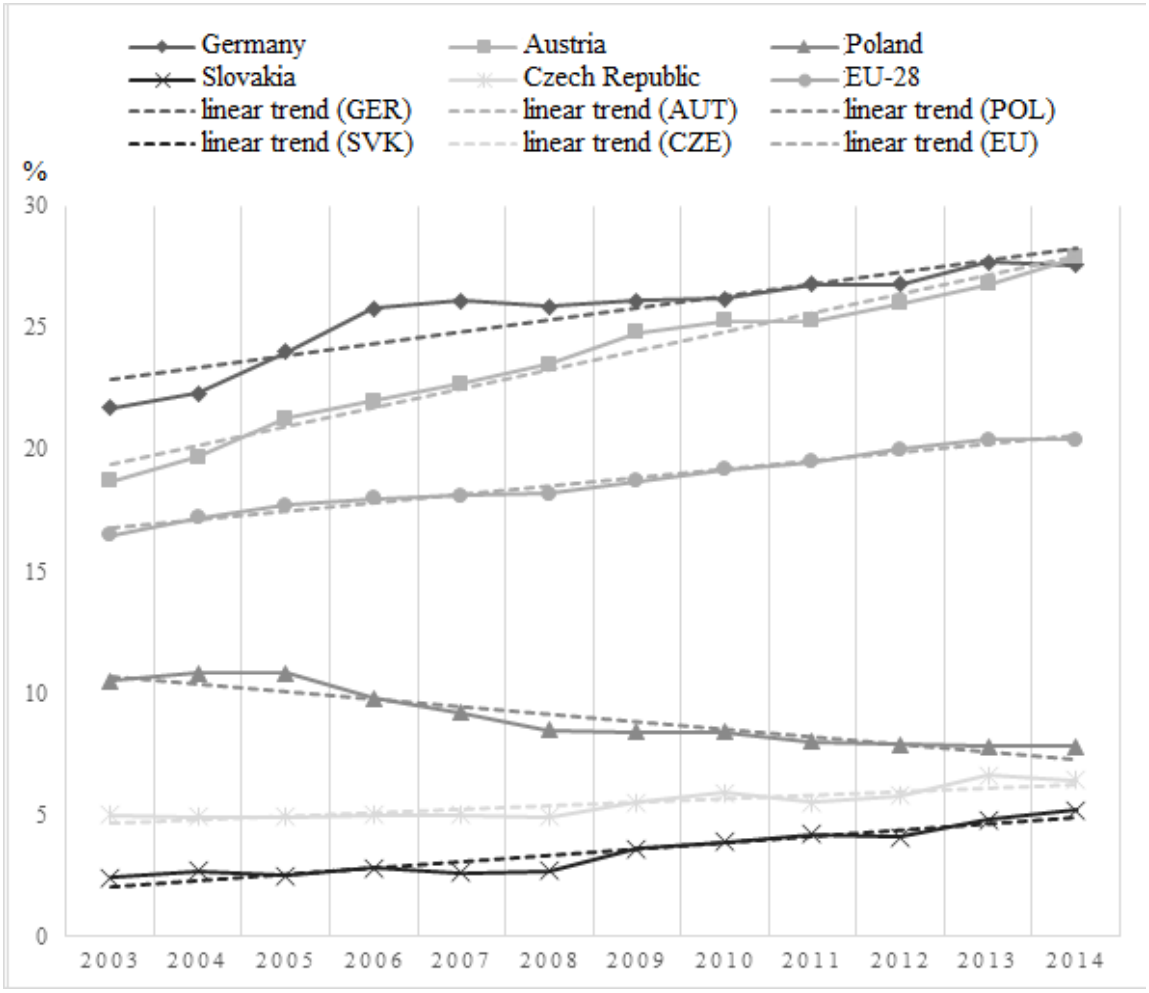


Chart 1: Use of part-time job in selected countries in percentage (Eurostat, 2015)

On detailed datas divided by genders we can se that part-time employment is more used by women than by men. It is shown on two examples: Austria, where the the use of part-time jobs by women is very high compared to man and Slovakia, where both numbers are very low. But still, the use of part-time jobs by women almost doubles the use by men.

Table following on the next page

Table 2: Use of part-time job in Austria by genders, in percentage (Eurostat, 2015)

Year / Gender	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total	18,7	19,7	21,3	22,0	22,7	23,5	24,8	25,3	25,3	26,0	26,8	27,9
Men	4,7	4,9	6,2	6,6	7,2	8,2	8,8	9,2	8,9	9,2	10,3	10,9
Women	36,0	37,8	39,5	40,4	41,2	41,6	43,1	43,8	44,1	45,1	45,6	46,9

Table 3: Use of part-time job in Slovakia by genders, in percentage (Eurostat, 2015)

Year / Gender	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total	2,4	2,7	2,5	2,8	2,6	2,7	3,6	3,9	4,2	4,1	4,8	5,2
Men	1,3	1,4	1,3	1,3	1,1	1,4	2,7	2,8	2,8	2,9	3,4	3,9
Women	3,8	4,2	4,1	4,7	4,5	4,2	4,7	5,4	5,9	5,7	6,4	6,9

Thus we can say that lowe usage of part-time employment in Czech Republic (but also in Poland and Slovakia) blocks women from entering the labour market (especially in case of women with children). This group of employees is one of the endangered groups on the labour market.

5. CONCLUSION

The current development of labour market makes the issue of atypical and flexible types of employment more actual than ever. Few decades ago, it was typical for people to work in one job position for most of their life and usualy for the standard working hours. Today, more people are looking for part-time jobs for many reasons: they need side-job to earn more money or they don't want to spend whole week doing their job and they want more time for their families or hobbies. People also change their jobs more often than it was usual before. Therefore we can se a rise in the use of part-time jobs among population in the last 15 years. 16,5 % of workers worked in part-time job in 2003 and 20,4 % did the same in 2014 and the trend is continuing. We can se that the countries of the the Western Europe are in advance in this develompent comparing to the countries of the former Eastern block. Regarding the situation in Czech Republic and its neighbouring countries, use of part-time job is much more frequent in Germany and Austria (more than 20 %) than in Czech Republic, Poland and Slovakia (less than 10 %). These figures are very low and has to be changed. We can expect a significant decreas of employment in next 10-15 years due to automatization caused by Industry 4.0. The society has to be prepared for upcoming changes and use of part-time employment (and other alternative forms of employment, like minijobs, job-sharing, short-time jobs) are a possible way how to mitigate the consequences of the increase of unemployment in the society, because shortening the working hours could be a way to keep jobs available for more people. This preference of alternative forms of employment can be theoretically connected with the concept of flexicurity introduced by the the Green Paper on

modernising labour law published by European Committee. So we can se that these objectives are part of the policies of European Union but the realisation of these objectives is not that strong, at least in the countries of the Eastern part of European Union.

LITERATURE:

1. Andrew, P. (2014). Fast Forward 2030, The Future of Work and the Workplace. CBRE: Los Angeles. Retrieved 2017-05-10 from: http://www.cbre.com/~/media/images/research%20reports/apac/2015/cbre_genesis_fast_forward_workplace_2030_full_report_e.pdf
2. Barancová, H. (2013). Teoretické problémy pracovného práva. Plzeň, Aleš Čeněk.
3. Wolter, M. I. et al. Industrie 4.0. und die Folgen für Arbeitsmarkt und Wirtschaft. IAB Forschungsbericht. 8/2015. Nürnberg: IAB. Retrieved 2017-05-10 from: http://doku.iab.de/forschungsbericht/2015/fb0815.pdf
4. Bělina, M. (2009). České pracovní právo po novém zákoníku práce. In Bělina, M. et al. Pocta Petru Trösterovi k 70. narozeninám. Praha: ASPI.
5. Dolobáč, M. (2014). Zmluvná autonómia v pracovnom práve. In Olšovská, A. et al. Labor ipse voluptas: Pocta prof. JUDr. Helene Barancovej, DrSc. Kraków: Spolok Slovákov v Poľsku – Towarzystwo Słowaków w Polsce.
6. Eurostat: Persons employed part-time. (2015). Retrieved 2016-04-18 from: http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tps00159&language=en
7. Galvas, M. et al.. (2015). Pracovní právo. Brno: Masarykova univerzita, 2015.
8. Galvas, M. (1994). K základním otázkám svobody smlouvy v pracovním právu. In Galvas M. et al. Smluvní princip a jeho projevy v individuálním pracovním právu. Sborník příspěvků ze sympozia Brno, 17. února 1994. Brno: Masarykova univerzita.
9. Green Paper: Modernising labour law to meet the challenges of the 21st century. Brussels: Commission of European Communities. (2006). Retrieved 2017-05-10 from: http://www.europarl.europa.eu/meetdocs/2004_2009/documents/com/com_com(2006)0708_/com_com(2006)0708_en.pdf
10. Hůrka. P. (2009). Ochrana zaměstnance a flexibilita zaměstnávání: Princip flexijistoty v českém pracovním právu. Praha: Auditorium.
11. Hůrka, P. (2011). Pracovní právo ve světle flexicurity. In Barancová, H. et al. Možnosti a hranice liberalizácie pracovných vzťahov. Bratislava: Sprint dva.
12. Janičová, E. (2009). Flexibilný trh práce a limity zmluvnej slobody v pracovnom práve. In Barancová, H. et al. Pracovné právo 21. storočia. Plzeň: Aleš Čeněk.
13. Madsen, P. K. (2002). The Danish Model of „Flexicurity" – A Paradise with some Snakes. In Interactions between Labour Market and Social Protection. Brussels: European Foundation for the Improvement of Living and Working Conditions. Retrieved 2017-05-10 from: http://www.eurofound.europa.eu/sites/default/files/ef_files/ewco/employment/documents/madsen.pdf
14. OECD Data: Part-time employment rate. (2017). Retrieved 2017-05-10 from: https://data.oecd.org/emp/part-time-employment-rate.htm
15. Olšovská, A. (2014). Flexibilné zamestnávanie v Slovenskej republike – agentúrne zamestnávanie. In Olšovská, A. et al. Labor ipse voluptas: Pocta prof. JUDr. Helene Barancovej, DrSc. Kraków: Spolok Slovákov v Poľsku – Towarzystwo Słowaków w Polsce.
16. Stránský, J. (2014). Vývoj a postavení pracovního práva jako soukromoprávního odvětví. Brno: Masarykova univerzita.
17. Štangová, V. (2014). Ochrana zaměstnanců v pracovněprávních vztazích v podmínkách globalizace. In Olšovská, A. et al. Labor ipse voluptas: Pocta prof. JUDr. Helene Barancovej, DrSc. Kraków: Spolok Slovákov v Poľsku – Towarzystwo Słowaków w Polsce.

REGIONAL AND LOCAL SUSTAINABLE FOOD SYSTEMS GOVERNANCE: COLLABORATION AND COMMUNICATION

Raimonds Ernsteins
University of Latvia, Latvia
raimons.ernsteins@lu.lv

Anita Lontone-Ievina
University of Latvia, Latvia
anita.lontone@lu.lv

Ilga Zilniece
University of Latvia, Latvia
ilga.zilniece@lu.lv

Liga Zvirbule
University of Latvia, Latvia
liga.zvirbule@lu.lv

ABSTRACT

Sustainable food system (SFS) understanding is growing and SFS governance is becoming a comprehensive and complex public governance issue, covering entire food cycle and its impacts, including all three complementary governance system dimensions as also for SFS development - governance content and process as well as stakeholders' segments. Thereof, SFS governance is to be aiming at understanding and interdisciplinary governing of all horizontal interlinkages between food, environment, health risks, education etc. governance sectors, as well as vertical integration of governance levels, involving particularly regional and local governance levels, and, complementing there main governance stakeholders' also for SFS development as households, local municipalities and business sector, but especially all main local mediator groups - NGOs, media and formal/non-formal education (e.g. schools, museums, libraries) and experts/science representations. Field studies in urban/rural coastal pilot regions in Latvia has been carried out 2012-2014, performing case study research (CSR), incl. complementary methods as document analysis, interviews and questionnaires, as well as municipal stakeholders' pro-environmental behaviour semi-structured interviews in 2014-2016. Existing municipal level practice pieces and instruments are diverse developed enough to influence and promote SFS governance also at local level, and this, only partly yet used, potential could be clearly defined and integrated into municipal development planning/governance, including complementary application of all six governance instrument groups (political-legal, planning, institutional-administrative, infrastructure, economic-financial and communication) and ensuring the collaboration of internal and external stakeholder groups in the municipality, leading step-wise towards establishing preconditions for SFS governance framework in Latvia.

Keywords: *Collaboration, Communication, Food system, Regional governance*

1. INTRODUCTION

With the increase of the world's population the demand for food is increasing, that in turn is significantly affecting natural resources - air, water, soil quality, climate, biodiversity. In order to meet the growing demand it is important to think how to make the food life cycle stages as the whole food system more environmentally friendly already, thus ensuring eventual food system sustainability. Then governance system development of such systems is

to be seen as the crucial issue. The most significant environmental impacts of food appears in the early stages of food production, when the balance of the resources is not taken into consideration and households affected by the already existing environmental impact contribute to it as well by their food choices, food service demand based on their wishes. Households also directly affect the environment through food-based energy consumption and waste generation. Changes in the environment cannot be seen immediately, but will be visible years later due to reduced human's natural ability to resist external environmental factors - weakened immunity etc.

Sustainable food systems (SFS) governance includes the whole governance cycle (problem analysis, policy, planning, and management). Already Brundtlad Report by the UN World Commission on Environment and Development was adressing food security and production as well as consumption issues in terms of their impact on the environment. To understand the importance of this food system's issue in the context of environmental governance it is important to look at the full life cycle of the food - food production, processing, distribution, consumption and recycling. Governance of the entire **food life cycle is currently underdeveloped**, when we are looking into regional and local level perspective, compare to international approaches developed. Also in Latvia there have been only a few studies focused on sustainable life cycle assessment of food products, and almost none on its comprehensive cross-sectorial governance development. Even though a number of food related issues are addressed both by strategical and operational documents, emphasizing importance of cleaner production, greener consumption, organic farming, and sustainable business, a life cycle assessment of food products and importance of sustainable food **governance is not yet sufficiently integrated** in all levels of policy making in fields such as environmental protection, economics, agriculture, energy, waste management, etc.

At the same time, main regulatory environmental governance tools used for the reduction of food industry environmental impacts, do promote some positive-development towards more sustainable food production. Food quality impact on health is much more emphasized and explored issue, but is it adequately managed as well, especially from environmental point too ? It should be noted that environmental management practices often has been not sufficiently integrted into other formal policy sector development considerations. Therefore, there is a need for particular sustainability target oriented policy developments for all food production, manufacturing, distribution and consumption related industries.

Can local municipality or group of municipalities at the regional self-governance level influence and promote sustainable food production and consumption? Management and environmental management tools, which municipalities have at their disposal, are enough diverse, even not always used. Theoretically municipalities possess potential to influence and promote both sustainable food production and consumption at local environmental governance level. Sustainable food production and consumption as the whole food cycle system could be stated as local municipal development planning and implementation issue, and, subsequently formulated in the mandatory municipal planning documents - sustainable development strategy, development programme and land use plan in Latvia – since, obviously, having already all main food systems related sectors and issues like business promotion, social policy and environmental quality considerations.

2. RESEARCH-AND-DEVELOPMENT METHODOLOGY

To study the current situation, quantitative and qualitative research methods were used, but also subsequent policy initatives were developed and step-wise tested, applying research-and-development (R&D) methodology both in collaboration with main municipal stakeholder groups. Studies were carried out by Environmental Management Department, University of Latvia, in 2012-2014 - field studies in urban and rural environment, under the framework of

Interreg FOODWEB project, performing case study research (CSR), incl. complementary methods as document analysis, interviews and questionnaires, particularly, in the salacgriva rural municipality. As well as municipal stakeholders' pro-environmental behaviour semi-structured interviews were done in 2014-2016 in several case territories, incl. Salacgriva too. The last included: document analysis – analysis of planning and legislative documents, reports and other studies; interviews with main stakeholders - in-depth and focus group interviews on pro-environmental behaviour development and practice local municipalities, incl. food sector, instruments, integration and stakeholder group co-operation.
CSR methodology was used to explore the case of sustainable food systems approach and governance promotion vs. interests for all stakeholders in coastal municipalities. The research team carried out analysis of all the relevant documents (regulations, planning documents, reports etc.) as well as conducted express surveys, in – depth interviews and focus group discussions with the key stakeholders. Issues related to food systems building and environmental governance in local municipalities, environmental/food instruments and their integration, also stakeholder collaboration were discussed. The governance process approach, systems approach, sectoral and integrative planning approaches, disciplinary and integrative development instruments approach, collaborative governance and communication approach as well as sustainable food development communication approach were used in the study.

3. RESULTS AND STAKEHOLDERS INITIATIVES

This study as well as literature available and other research results do indicate, obviously, many different factors that affect food life cycle and the whole food system governance, and, also impact of each food life cycle stage on the e.g. depletion of natural resources, as a result leading not only to general reduction of available resources, but also to the natural growing/producing food shortages.
At the first stage of our SFS ogovernance study in 2012-2014 related assessments have been done, including central Baltic partnership - the project 'The Baltic environment, food and health: from habits to awareness (Foodweb)' was one of the first projects aiming comprehensively at raising public awareness about the links between food, environment and the related risks and it contributed to food-environmental awareness and risk alertness measures and products, being implemented later on in Finland, Estonia and Latvia. Foodweb project feasibility study conclusions, related to this paper, could be combined as this: when looking at the consumption habits in the long term there are diminishing differences between the countries seen and we share the common concern of environment and food safety issues; consumers prefer locally produced food and amount of organic production is increasing, but in spite of that, consumers do not know that cultivation of food and related production activities might cause negative environmental impacts; agriculture, transportation and wastewaters from the industry, energy production and urban areas have strongly increased the nutrient load in the sea, and, 75 % of nitrogen and 52 % of 14 phosphorus come from agriculture and the livestock sector (Foodweb, 2011).
However, the aim, for this part of study done and represented in the paper, is not to study and describe neither environmental nor health related issues and factors, but to concentrate case study research and later on organized interviews on stakeholder's interests and their recommendations, and, particularly, municipal possibilities to focus their potential and to develop municipal and/or regional level SFS governance framework.
In this relation the study attempted to analyse and generalize the municipal environmental and food system governance instruments, viewing these instruments through the perspective of the food life cycle. It should be noted that management instruments are both governance process and product /result oriented. These instruments are clearly conditional and often one and the same instrument at a particular type of activity could be both disciplinary as well as

integrated into other municipal instruments. Efficient implementation of sustainable food governance requires mutually complementary use of **all available governance instruments:** political and legislative instruments, planning instruments, economic and financial instruments, administrative and institutional instruments, infrastructure instruments, communication instruments, and voluntary instrument examples – among the most important ones.

As for the first step approaching eventual SFS governance framework, we need to look at the general development planning system in Latvia, and particularly, **mandatory/voluntary planning instruments** (most comprehensive type of instruments), which has been supported at the international level, having had Marrakesh process and sustainable consumption and production overall planning frame impact and whole set of food management legislation. Concerning supra-national regional level in the Baltic Sea region area we can also find various EU and Baltic region incentives documents and approaches, so facilitating national developments, also being supported by various international/Baltic Sea regional funds and projects. Foodweb project also elaborates on the importance of integration of environmental and food sustainability aspects (such as reduction of environmental degradation, green economic policies, development of green technologies etc.) into all stages of policy planning.

At the national level, the food related issues are generally addressed by the main planning documents, either for strategic (Sustainable Development Strategy of Latvia until 2030) or mid-term (National development plan 2014-2020) planning, as well as the Law on Consumer Rights Protection, Law On the Supervision of the Handling of Food, Environmental Protection Law, the Law on Local Governments. These documents emphasize importance of cleaner production, improvement of technology, green consumption, organic farming, support for sustainable business development, promotion and use of eco-design recycling and integration of environmental requirements into sectoral policies. As well as there are the Regulations of the Cabinet of Ministers related to the food quality schemes, their implementation, operation, monitoring and control procedures.

At the sub-national regional level, being in Latvia an non-elective governance level (local municipalities leaders are collectively establishing governance council and taking planning decisions) and local municipal level, aiming towards more sustainable food system, have been mentioned quite widely and diverse into different local planning documents, both comprehensive mandatory development planning ones and voluntary sectoral ones, for example, business or tourism sector, as well as integrated into some food and business related projects, for example, Vidzeme region food cluster.

At the local governance level issues related to food sustainability have to be addressed also at the household level, being not always fully recognized by planners and politicians. National statistics having some data also on food consumption at the household level can give only very general description and does not tell whether it is environmentally friendly or not. Attention should also be paid to the promotion of home business - home food producers, having more local and traditional products, related also to local eating habits in the area, even representing certain way of living and/or local culture traditions.

Most easy and least expensive traditionally are **communication instruments** (especially, also collaboration instruments as type on instruments to be possibly developed within any group of those six groups of instruments mentioned). Municipalities often are not so active and effective in applying any kind of communication type instruments, especially, specific sector/cross-sector oriented ones. But, general public and main other stakeholders do recognize and value such instruments highly and are active initiators and supporters of those.

CSR research and, particularly, in Salacgriva municipality later done, focus groups as well as policy formulation roundtables have brought to the live a number of shared and collaboratively designed governance initiatives.

One of such example is the list of SFS governance voluntary instruments, being gathered by stakeholders and discussed as having all necessary details in order to be realized into municipal practice nation wide (see Table 1.).

Table 1. Examples of voluntary instruments in Latvian municipalities (R. Ernsteins et al 2013)

Instrument	**Anotation**
Marketing of local and organic produce through tourist oriented channels	- brochure on local organic farms, distributed through the tourist information center, - local products marketed with inscription "Made in the municipality of X", "Catch from the local river / lake," etc., - local food tours and tours to local organic farms to be used also in the formal school study process during student “projects week”, - separate trading places at trade fairs for organic farm and local fishermen produce, - signs indicating the local origin of food placed at the restaurants, hostels and guest houses. For example, " Food here is prepared using local produce"; - ancient cooking recipes exhibited in museums, exhibitions (e.g. "Recipes from Grandma's dowry") - local food festivals, like already traditional Lamprey festival in autumn in Salacgriva on Salaca river etc.
Contests on sustainability in cuisine	- contest for the best catering service provider with nominations "The healthiest food", "Environmentally friendly food" and so on, as well as "Environmentally friendly service provider", "Local food of the X district, ", - Establishing a certification system at the municipal level, eco-friendly food or local traditional food.
Informative and educational activities	- books on healthy food and other similar topics exhibited in local libraries and education activities around them for all target groups, - section on municipality website, where people can express their views on food and environmentally friendly food production, - opinion polls for local residents at the website of municipality, addressing issues of food consumption, etc; - organic farmers visiting schools, kindergartens, local fairs, etc. - information materials about organic/environmentally friendly farms in local area.

4. DISCUSSION ON COLLABORATION APPROACH DEVELOPMENTS

Collaborative governance model (Ernšteins, 2009: p.160) is offered as a food governance systems framework model. The model is based on the concept that food governance must be implemented through integrative collaboration of all major its governance cycle components - model consists of 5 main and complementary and subordinate components:

1. Governance internal and external stakeholder groups mutual collaborative development;
2. Vertical inter-level and horizontal cross-sectorial **thematic** collaborative development;
3. Governance instruments (all main six groups) collaborative development;
4. Governance monitoring/**assessment** collaborative development;
5. Collaborative governance **communication** development.

Collaborative development and its governance (see Fig. 1), first of all, is target groups oriented - focused on the development and/or improvement of collaboration between all actors involved in food life cycle or all involved stakeholder groups, both vertical collaboration – top-down approach, and horizontal collaboration between local residents, local municipality and mediators.

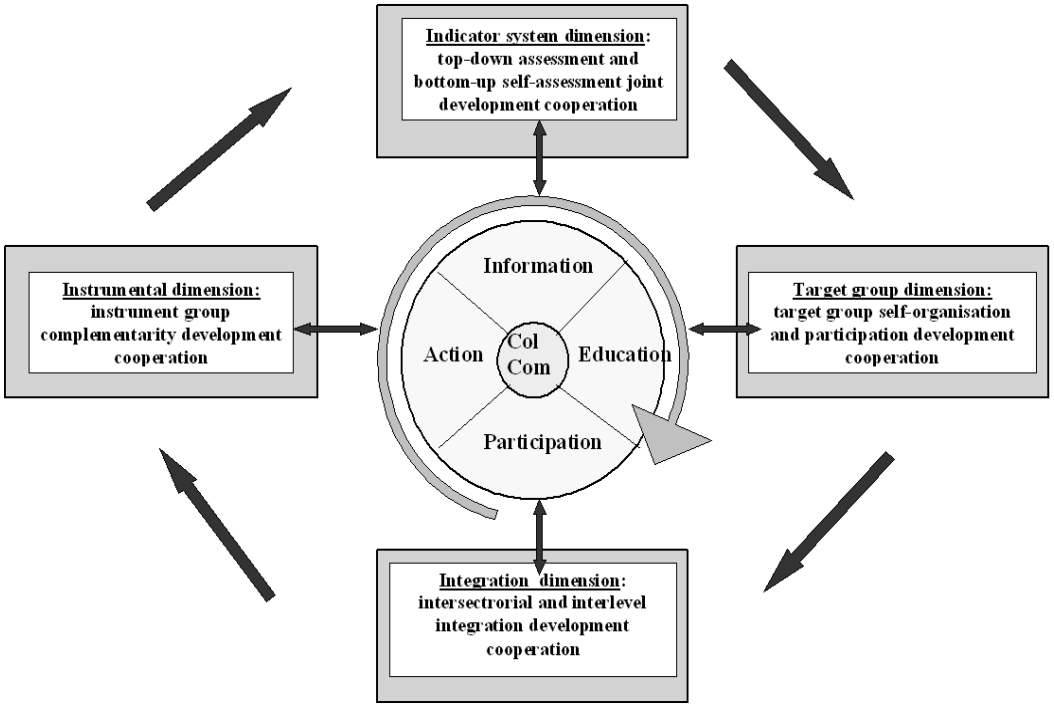


Figure 1. Food governancet cycle at local governance level: collaboration governance model components (R. Ernsteins 2008)

The second component of the model is vertical and horizontal integrative thematic collaborative development. The goal here is to ensure that certain food system content is integrated in both – horizontally into all sectors and vertically into all levels of governance, and, finally, providing mutual vertical and horizontal thematic (food system) collaboration development. The third component of model emphasizes that for the successful governance implementation adequate application of all 6 environmental governance instruments is to be secured: political and legislative instruments; planning instruments; economic and financial instruments (e.g. tax policy, support programmes /fundraising, public-private partnerships, promotion of eco-certification, green procurement etc.); administrative and institutional instruments; infrastructure instruments; communication instruments. The fourth component

of the model deals with the development of governance implementation monitoring, quality assessment system. This is an indicator system based assessment approach that takes into account the development and application of two type indicator approaches - top-down and the bottom-up - into their consistency. Thus the food system governance development practice could be facilitated and evaluated by all stakeholders. The final fifth model component is focused to ensure continuous improvement of stakeholders communication, which is to be done as a collaboration communication, being most essential driving force to the collaborative governance in general. The communication toolkit includes: collaborative governance information, education and participation practice, creating and spreading collaborative governance best practices. Salacgriva municipality, being active and interested to serve as a model territory for several research and development projects, has been testing area also for various indicator systems development, particularly for designing and testing both complementary thematical and territorial approaches based municipal indicator systems (IS). Approaches were applied as for different thematically cross-sectorial municipal IS (coastal and climate change governance etc.) and, interrelatedly, eventual whole municipal development governance IS. There was also designed Sustainable development governance IS proposal for Salacgriva municipality, being a part of mandatory municipal long term planning document - Sustainable Development Strategy. Subsequently, there were elaborated and initially discussed with stakeholders' groups also proposal for SFS governance indicators list (see Table 2.) This is still ongoing process, but is giving an additional opportunity for mutual integration of food system governance issues with coastal, environmental and climate change governance ones.

Table 2. Start-up proposal for Salacgriva municipality sustainable food system governance indicators list (shortened version for practical reasons).

Action group	Indicator	Measure unit
Production and primary food processing	Biological farms	number, share %, agricultural land share %
	Individual fishermen, including inland waters	number; product output, EUR
Food processing and production Agriculture	Individual producers – small farmers and craftsmen	number
	Agricultural co-operation	Number of members
Food distribution to consumers	Individual sellers of self-grown produce in the local market	number
	Local produce for the consumption by population	% of population; character of distribution
	Local produce in school kitchens	%
	Healthy food departments in stores	% of all stores
Consumption habits and knowledge on environmentally friendly and healthy food	Healthy food purchasing frequency	assessment
	Dietary use of self-grown food	assessment
	Motivation of using healthy food	group % distribution
	Knowledge assessment and self-assessment	assessment

Presented list of drafted SFS governance indicators list, elaborated and discussed during mentioned municipality-university partnership project, do have mainly theoretical impact on further R&D studies and municipal practice as neither this nor territorial indicator system for Sustainable Development Strategy have not been yet implemented in practice by municipal Council decision. Development and application of an indicator system do require not only

financial, but also administrative resources and capacities, what for comparatively small rural type municipalities as Salacgriva (around 9000 inhabitants) is not an excess.

5. CONCLUSION

Sustainable food production and consumption (SCP) is a complex governance issue, covering all governance levels, sectors and stakeholder groups. Development of sustainable food governance (reduction of environmental impacts, changes in consumption, etc.) is affected by multiple socio – economic and ecological factors and can be achieved only in long term. Consistent cooperation among stakeholders and application of collaborative governance approach is a necessary prerequisite for this long term goal. Systemic food life cycle governance is necessary both in the national and local / municipal level. Inclusion of sustainable food production and consumption as a **unified governance principle** into related sectoral development policies practice requires not only a clear definition of the principle in the development policies and formal acceptance of the principle, but also the operation of the principle, that in turn requires appropriately developed, mutually agreed action programmes. Following is the Fig.2., where specially elaborated SCP governance frame model, with all related collaboration governance componnts, could be seen.

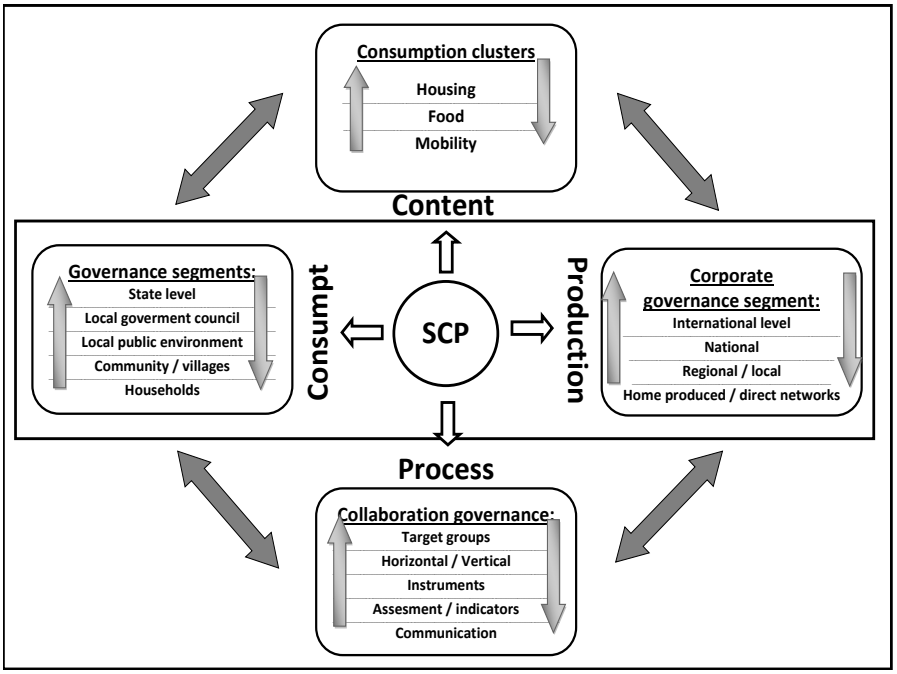


Figure 2. Sustainable consumption and production (SCP) governance frame model within content, process and stakeholders management segments interaction (R.Ernsteins, 2010)

Collaborative governance practice, in turn, requires development of collaborative communication - information, education/training, participation, and collaborative, sustainable food system friendly, actions of all stakeholders. Sustainable food production and sustainable food consumption are to be mutually integrated with environmental and related other sector policies for all and different vertical and horizontal governance levels and sectors. This means that governance instruments selected for the whole food system - food production, distribution and consumption - must be specially targeted, coherent, cumulative and complementary in their realization activities for all related policy sectors. The municipality has sufficiently diversified and structured governance instruments for sustainable food production and consumption development, esp. voluntary instruments are the most powerful

instruments in raising awareness and promoting sustainable consumption. In the course of the project study and seminars, academic and applied recommendations were developed

Sustainable food governance is a complex process that depends on the interaction of a variety of interdependent factors. Successful development and improvement of sustainable food governance process in Latvia is possible through the complementary planning and implementing of collaborative governance of the entire food governance cycle and all four vertical governance levels complementary (R.Ernšteins,O.Bērziņš,2013):

- national level of governance, providing the State (cross-ministerial) sectoral policy/action policy collaboration for the SFS governance;
- regional level of governance, providing the regional stakeholder groups collaborative governance for sustainable food governance;
- local governance level, providing local food life cycle and stakeholder group communicative collaboration for sustainable food governance;
- household governance level, generating public interest in consumer and local home producers' sustainable food collaborative governance.

Sustainable food consumption communication (R.Ernšteins, I.Paidere 2013) can be used as an effective tool for promoting sustainable consumption in Latvian municipalities:

- local municipalities should be aware of sustainable food consumption importance as part of the community and the territory development and integrate sustainable food consumption issues in the municipal development planning and administration, complementary using management instrument groups - political and legislative, planning, economic and financial, administrative and institutional, infrastructures, and in particular - communication tools, thus ensuring both the proper application of other instruments in the communication society and all the local municipality's internal and external stakeholder group communication;
- it is necessary to provide sustainable food consumption communication with local municipality's stakeholder groups as well as with national level institutions and scientists/experts will be encouraged for the pro-active participation of the mediators, at the same time contributing to both the trainers and the media, NGO mutual collaboration;
- in the process of sustainable food consumption communication with local households, the known collaboration communication model instruments should be complementary used, both information and education, public participation and sustainable food consumption friendly/adequate action, minimizing the public food consumption process impacts both on the environment and the public health.

Initial results provide the opportunity to summarise the proposals voiced by the target groups concerning prospects for environmentally friendly food communication development. Some examples of the proposals may include: expansion of extra-curricular educational opportunities (through collaboration among schools, NGOs, museums etc.); use of museum potential in promoting health and environment friendly food (high visitor rates); lobbying of local agricultural production – the green procurement, agreements with the local farmers, etc.; use of interactive/visual examples, experiments or tests; development of a local certification system – for better recognition of health and environment friendly food; offer schools comprehensive, clear-cut data for use in the teaching process; creation of a health and environment friendly food bus etc.

Food production and consumption could not be yet sustainable in Latvia, but local municipalities already are able to influence, promote sustainable food production and consumption. Next step is to recognize and understand this initial experince by municipalities themselves and adequately integrate SFS governance system issue into mandatory

development planning documents - sustainable development strategy/development program, land use plan – and to organize related governance system practice. Real interest and perceived need of particular municipalities is to develop even voluntary local SFS sectoral (cross-sectoral) governance planning documents. Mentioned and in complementary combination with the step wise started municipal-business collaboration (sectoral policies, e.g. agriculture, environment, economics etc.) at the regional governance level, and finally, having perspective development of cross-ministerial support mechanisms at the national level are necessary steps towards SFS governance framework elaboration, based on models elaborated and described.

ACKNOWLEDGMENT: *Research-and-Development data were collected and elaborated upon, and the paper prepared, within the framework of the Latvian National Research Program Project on Environmental Diversity and Sustainable Governance (SUSTINNO, 2014–2017). There shall be acknowledged following university contributors taken part into the realization of previous CSR projects mentioned – Krista Osniece, Ugis Rusmanis, Ivars Kudrenickis, Valdis Antons, Diana Sulga, Sintija Kursinska, Daiga Stelmahere as well as master students involved and contributed municipal leaders, planners and other stakeholders from CSR pilot areas.*

LITERATURE:

1. Borrás, S. (2011). *Policy learning and organizational capacities in innovation policies.* Science and Public Policy. Vol. 38, Issue 9, pp. 725-734
2. Busch, L. (2011). *Food standards: the cacophony of governance.* Journal of Experimental Botany, *2011 (62*), pages *3247-3250.*
3. Capone, R., El Bilali, H., Debs, P., Cardone, G, Driouech, N. Food System Sustainability and Food Security: Connecting the Dots. *Journal of Food Security*. 2014; 2(1):13-22. doi: 10.12691/jfs-2-1-2.
4. Cashmore, M., Richardson T., Rozema J., Lyhne I. (2015). Environmental governance through guidance: The 'making up' of expert practitioners. Geoforum.Vol. 62, pp. 84–95
5. Cretella, A., Buenger, M. S. (2016). *Food as creative city politics in the city of Rotterdam.* Journal of Environmental Accounting and Management. Article ISSN: 02642751, DOI: 10.1016/j.cities.2015.12.001. Elsevier Ltd.
6. Emerson, K., Nabatchi, T., Balogh S. (2012) *An Integrative Framework for Collaborative Governance.* Journal of Public Administration Research and Theory, 22 (1): 1-29.
7. Ernsteins R., Kaulins J., Zilniece I., Lontone A. *Coastal Governance Solutions Development in Latvia: Collaboration Communication and Indicator Systems* (Chapter 6). Coastal Zones: Solutions for the 21st Century (ed. J. Baztan, JP. Vanderlinden at al). Elsevier. 2015, pp. 85-96.
8. Halloran, A., Magid, J. (2013). *The role of local government in promoting sustainable urban agriculture in Dar es Salaam and Copenhagen.* Department of Plant and Environmental Sciences, University of Copenhagen, Denmark.
9. Hernández-González Y., Corral S. (2017). *An extended peer communities' knowledge sharing for environmental governance.* Land Use Policy. Vol. 63, pp. 140-148
10. Lontone, A., Ernšteins ,R., Paidere, I., Bērziņš, O., Zvirbule, L., Zīlniece, I., Frīdmanis J. (2013) *Sustainable food governance framework in Latvia: collaboration and communication.* Scientific conference Proceedings „Laboratory Diagnostics in Veterinary Medicine, Food and Environmental Safety", Riga, BIOR, pp. 49-50.

11. Melece, L., Krievina, A. (2015). *Growth of food sector's productivity through innovations.* Management Theory and Studies for Rural Business and Infrastructure Development. ISSN 1822-6760/e, ISSN 2345-0355. DOI: 10.15544/mts. 23 Vol. 37. No. 2: 252–263.
12. Melece, L., Romanova, D. (2007). *Issues of sustainable food production in Latvia.* Economics and Rural Development. Vol.3, No.2, ISSN 1822-3346.
13. Schmidt K. (2016). *Explaining and promoting household food waste-prevention by an environmental psychological based intervention study.* Resources, Conservation and Recycling. Vol. 111, pp. 53-66
14. *The Baltic environment, food and health: from habits to awareness: Central Baltic INTERREG IV Programme 2007-2013.* (2011). MTT Agrifood Research Finland.

GOVERNANCE OF THE EUROPEAN UNION'S SOCIAL POLICY: STATE OF PLAY OF THE EUROPE 2020 STRATEGY AND SOCIAL INVESTMENT PACKAGE IN EUROPAN UNION AND REPUBLIC OF CROATIA

Martina Drventic
Junior researcher on project "Planning the future of cross-border families: a path through coordination" (EUFam's)
Josip Juraj Strossmayer University of Osijek, Faculty of Law
Stjepana Radića 13, 31000 Osijek
mdrventic@pravos.hr

ABSTRACT
In last two decades the EU Member States faced important social challenges such as inequality, social exclusion, poverty and immigration. Those challenges created a need for reforms of the education, pensions, social protection and healthcare systems. Financial crisis of 2007 pointed towards numerous structural weaknesses in the economies of the Member States implying the importance of constructing a new economic model for the EU. As a response to both, the EU introduced the social investment perspective by adopting the ten-year strategies. The current, Europe 2020 Strategy has set target to lift at least 20 million people out of poverty and social exclusion and to increase employment of the population aged 20-64 to 75%. It is consisted of number of social objectives such as employment, research and development, education, fight against the poverty and promotion of social inclusion. In order to achieve its objectives the Strategy has introduced a revised system of governance for the supervision and consolidation of Member States – the European Semester. As a result of expressed need for social dimension, the EU's social policy was strengthened by adoption of the Social Investment Package, general set of guidelines for the EU's social policy. The Package is emphasizing the significance of the social investments but it not indicates the precise targets, only asks Member States to specify all progress made in national reforms and premises in order to create progress indicators to better guide them. This paper will present the impact assessment of the governance of the Europe 2020 Strategy and of the monitoring over the Social Investment Package, both in general and trough the overview of the European Semester timeline with regard to Republic of Croatia.
Keywords: *Europe 2020 Strategy, European Semester, governance, social investment, Social Investment Package*

1. INTRODUCTION

Poverty and social exclusion reduces the quality of individual's life and limit them to achieve their full potential by affecting their health and well-being. This reduces the opportunity to lead a successful life and increases the risk of poverty. To prevent the transmission of poverty among generation the effective educational, health, social, tax benefit and employment systems are needed. Otherwise, the poverty will sustain and will create more inequality, which can hinder inclusive and sustainable economic growth. To prevent the above mentioned the European Commission has made "inclusive growth" one of the three priorities of the Europe 2020 Strategy. Even before the Europe 2020 Strategy, the EU had showed the significant orientation toward the social investment. For the first time this concept came to life in the Lisbon Strategy (Babić, Baturina, 2016, p. 47). It was launched at the European Council meeting in Lisbon in March 2000 and had represented the main strategic framework for development of the EU in the past decade (Samardžija, Butković, 2010, p. 5). The

intention was to find a solution to stagnation of economic growth in the EU, through the policy initiatives that were to be implemented by all Member States. As it was explained by the European Council, the EU was confronted with a quantum shift from globalisation and the challenges of a new knowledge-driven economy (European Council, 2010, para. 1). A new strategic goal for the upcoming decade was to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. In order to achieve this goal the Lisbon Strategy set three tasks by putting the equal weight to the full employment and social cohesion alongside economic growth and competitiveness as EU objectives (Zeitlin, Vanherche, 2014, p. 16). To advance its ambitious agenda the Lisbon Strategy relied on the Open Method of Coordination (hereinafter: OMC), a method of soft governance, based on the interactive benchmarking of national progress towards common EU objectives and organized mutual learning (Zeitlin, Vanherche, 2014, p. 16). The OMC was described as a "third way" of governance which is to be arranged when "harmonisation is unworkable but mutual recognition and the resulting regulatory competition may be too risky" (Szyszczak, 2006, p. 488). It relied on mechanisms such as: fixing guidelines for the Union combined with specific timetables for achieving the goals; establishing quantitative and qualitative indicators and benchmarks tailored to the needs of different Member States; translating the European guidelines into national and regional policies by setting specific targets and adopting measures; periodic monitoring, evaluation and peer review organised as mutual learning processes (European Council, 2010, para. 37). The results of the evaluations were not explicitly binding for Member States, but there was an element of peer pressure in the OMC which provoke Member States into action when they would not have acted on these issues of their own accord (European Parliament, 2017). In years immediately following the Strategy's initiation, the OMC was developed altogether in 11 policy fields, including research, education, social protection, employment, environmental policy and the information society (Samardžija, Butković, 2010, p. 5). However, the Lisbon Strategy gradually developed into an overly complex agenda with multiple goals and actions but unclear division of responsibilities and the results were weaker than expected (Samardžija, Butković, 2010, p. 5). The economic crisis revealed the overambitious targets set by the Lisbon Strategy and disabled possibility of any economy growth and job creation. Still, most of the critics referred to overambitious goals, to many targets and bureaucracy, lack of Commission's power to use it against the Member States and lack of commitment to the Strategy by a number of States (Barnard, 2010, p. 12). The need for a post Lisbon type strategy was expressed at the European Council summit held in March 2008. The European Council stressed that a continued EU-level commitment to structural reforms and sustainable development and social cohesion will be necessary after 2010 in order to lock in the progress achieved by the renewed Lisbon Strategy for growth and jobs. The European Council therefore invited the Commission, the Council and the National Lisbon coordinators to start reflecting on the future of the Lisbon Strategy in the post-2010 period (European Council, 2008, para. 6). This paper will argue the social policies established by the Europe 2020 Strategy and their governance within the European Semester in order to provide the conclusion regarding the effectiveness of the soft law mechanisms, by mean of analysis of EU's strategies, guidelines, consultations and documents issued within the 2016 European Semester.

2. EUROPE 2020 STRATEGY AND SOCIAL INVESTMENT PACKAGE

In its Communication from 2009 the Commission drew up a framework for the new strategy named Europe 2020 (European Commission, 2009, p. 11). The consultation process resulted in a great number of comments and proposals officially submitted by the Member States, various civil society organizations and individual citizens (Samardžija, Butković, 2010, p.

10). In general, all Member States agreed that governance must be improved to close the implementation gap of the Lisbon Strategy (European Commission, 2010, p. 9). For many Member States the existing mechanisms of implementation and monitoring was needed to be strengthened, including for many through a better cooperation between the Commission and the Member States leading to more precise and relevant country-specific recommendations (European Commission, 2010, p. 10). Finally, the Commission introduced the Communication "Europe 2020: a European strategy for smart, sustainable and inclusive growth". Compared with its predecessor the proposed strategy introduced new dynamism regarding its targets. Europe 2020 brought in a new and arguably better division of labour between various EU and Member State actors, while in the scope of implementation it introduced new mechanisms aimed at higher policy convergence (Samardžija, Butković, 2010, p. 11). Accepting the critics that the previous strategy's targets were vaguely defined, to broad and overlapping, the Europe 2020 Strategy put forward three mutually reinforcing priorities: 1) smart growth: developing an economy based on knowledge and innovation; 2) sustainable growth: promoting a more resource efficient, greener and more competitive economy; 3) fostering a high-employment economy delivering social and territorial cohesion (European Commission, 2010a, p. 1). Building on these priorities the new strategy stated that progress towards their fulfilment would have been measured against five representative headline targets: 1) 75% of the population aged 20-64 should be employed; 2) 3% of the EU's GDP should be invested in R&D; 3) the "20/20/20" climate/energy targets should be met (including an increase to 30% of emission reduction if the condition are right); 4) the share of early school leavers should be under 10% and at least 40% of the younger generation should have a tertiary degree; 5) 20 million less people should be at risk of poverty. To underpin its five targets the Commission put forward seven flagship initiatives on: 1) innovation; 2) youth; 3) the digital agenda; 4) resource efficiency; 5) industrial policy; 6) skills and jobs and 7) the fight against the poverty. These seven flagships initiatives were committing both the EU and the Member States (European Commission, 2010a, p. 1). The Social Investment Package (hereinafter: SIP), adopted by the European Commission in February 2013, represents a general set of guidelines for the EU's social policy which aims to formalize the place given to the social investment perspective in Europe. Also, it represents the result of many calls for a social dimension to the EU (Dinan, 2015, p. 5). It was accompanied by a Commission Recommendation on "Investing in Children: breaking the cycle of disadvantages" and a series of Staff Working Documents. They provide a policy framework for redirecting Member State's policies toward social investment, with a view to ensuring the adequacy and sustainability of budgets for social policies. The SIP provides guidance to help reach the Europe 2020 targets by establishing a link between the social policies and the reforms as recommended within the European Semester (European Commission, 2013. p. 3). The Commission urges Member States to better reflect social investment in the allocation of resources and general architecture of social policy, which means putting the focus on policies such as childcare, education, training, active labour market policies, housing support, rehabilitation and health services. Achieved progress should be reported in National Reform Programmes (hereinafter: NRPs) of Member States, while the Commission will monitor the efficiency and effectiveness of social systems and their emphasis on social investment in the framework of the European Semester (European Commission, 2013. p. 4).

3. GOVERNANCE OF THE EU'S SOCIAL POLICY. EUROPEAN SEMESTER

The Commission regained consciousness that the stronger economic governance will be needed in order to deliver results. It was determined by the Europe 2020 Strategy that the European Council had full ownership and had been the focal point of the new strategy. The

Commission is set to monitor progress towards the targets, facilitate policy exchange and make the necessary proposals to steer action and advance the EU flagship initiatives (European Commission, 2010a, p. 6). Unlike the Lisbon Strategy, Europe 2020 designed specific roles for the European Parliament and the national, regional and local authorities. The European Parliament is set to play an important role in its capacity as co-legislator but also as a driving force for mobilizing citizens and their national parliaments. National, regional and local authorities are set to contribute to the elaboration and implementation of the NRPs. (Samardžija, Butković, 2010, p. 13). On top of the already existing Lisbon practice of publishing policy recommendations the Commission introduced a possibility of issuing "policy warnings" as a means of last resort. Meaning that, if a Member State fails to meet its policy recommendation in the agreed time frame the Commission could issue a "policy warning" under Article 121 of the Lisbon Treaty. Ultimately, these warnings, which would need approval by Member States, could be made public, giving them more political weight (European Commission, 2010, p. 28). Between 2010 and 2013, the EU adopted a far reaching series of measures aimed to extend and strengthen the powers and capacities of European institution to monitor, coordinate, and sanction the economic and budgetary policies of Member States. The so-called Six Pack measures entered into force in December 2011. New economic governance measures have been incorporated in the European Semester of policy coordination (Zeitlin, Vangercke, 2014, p. 23). In this new governance approach the lack of governance between the Lisbon Strategy and the Stability and Growth Pact (hereinafter: SGP) was recognized as a serious problem. Therefore, in order to move towards better economic governance in the EU, as a third approach, it was proposed that the Europe 2020 Strategy and the SGP reporting and evaluation be done simultaneously. The aim was to bring the means and aims together, while keeping the instruments and procedures separate and maintaining the integrity of the SGP. This means that the annual Stability and Convergence Programmes (hereinafter: SCPs) and the streamlined NRPs is to be proposed simultaneously (Samardžija, Butković, 2010, p. 16). The five EU headline targets and the Europe 2020 integrated guidelines serves as a policy framework for the production of NRPs, while the SGP is the framework for the establishment of SCPs (European Commission, 2010b, p. 2).

4. EUROPEAN SEMESTER TIMELINE

The spring meeting of the European Council provides horizontal policy guidance for the EU and the euro area as a whole. It takes stock of the overall macro-economic situation and of progress towards the five EU headline targets. It provides policy orientations covering fiscal, macro-economic and thematic elements and advice on linkages between them. Member States should take these orientations into account when preparing their SCPs and NRPs (European Commission, 2010b, p. 3). The European Semester in its current form is sequenced in two successive phases, the European phase (from November to February) and national phase (from February to June). It begins each November with the Commission's Annual Growth Survey (hereinafter: AGS) and Alert Mechanism Report (hereinafter: AMR). AGS identifies the key economic challenges faces by the EU and suggests priorities for action, while reviewing Member State compliance with the previous year's Country Specific Recommendation (hereinafter: CSR) (Zeitlin, Vangercke, 2014, p. 24). The AMR is the starting point of the annual cycle of the Macroeconomic Imbalance Procedure (hereinafter: MIP), which aims to identify and address imbalances that obstruct the smooth functioning of the economies of Member States, the economy of the EU, and may jeopardise the proper functioning of the economic and monetary union. The report identifies Member States for which further in-depth reviews (hereafter: IDRs) should be undertaken so as to assess whether they are affected by imbalances in need of policy action (European Commission, 2015a, p. 3-5). In February, the Commission publishes a country report for each Member

State analysing its economic situation and progress with implementing the Member State's reform agenda. For those Member States selected in the AMR, the country report includes the findings of the IDR of possible imbalances the Member State faces. The Commission stressed that the effective reporting will enable the EU to undertake effective monitoring, surveillance and peer review of progress (European Commission, 2010d, p. 5). Hence, in April, Member States present their NRPs and their SCPs to the Commission. They report on the specific policies they are implementing and intend to adopt in order to reinforce jobs and growth, prevent or correct macroeconomic imbalances, and on their concrete plans to ensure compliance with the EU's recommendations. In May, the Commission assesses these programmes and proposes CSRs, which are reviewed and in some cases amended by the committees preparing the work for the sectoral Council formations, endorsed by the European Council, and then formally adopted by the Council, in late June/early July (Zeitlin, Vangercke, 2014, p. 25). Each Member State receives a single integrated set of CSRs. They cover a wide range of policy issues, including fiscal, budgetary, economic, employment reforms and also the wage determination, education, pensions, health care, poverty and social inclusion (Zeitlin, Vangercke, 2014, p. 27).

5. 2016 EUROPEAN SEMESTER

5.1. Autumn Package

In its AGS 2016 the Commission put forward the priorities for the 2016. Firstly it presented the current state of play: the EU's economy has been experiencing a moderate recovery; unemployment has been falling but remains at a historically high level; the recovery had reflected the first effects of reforms implemented in the last few years; economic performance and social conditions, as well as reform implementation, had remained uneven across the EU; the unprecedented inflow of refugees and asylum seekers over the last year had represented a significant new development in some Member States. In this context, the Commission proposed to focus efforts on the three priorities for 2016: 1) re-launching investment; 2) pursuing structural reforms to modernise economies; and 3) responsible fiscal policies. These priorities included a stronger focus on employment and social performance (European Commission, 2015, p. 3-5). The AMR identified that further IDRs should be undertaken in relation to Belgium, Bulgaria, Germany, France, Croatia, Italy, Hungary, Ireland, the Netherlands, Portugal, Romania, Spain, Slovenia, Finland, Sweden, United Kingdom, Estonia and Austria (European Commission, 2015a, p. 4). The results of IDRs showed that out of these 18 Member States, 6 have no imbalances, 7 have imbalances, and the remained 5 (including Croatia) have the excessive macroeconomic imbalances (Samardžija, Jurlin, Skazlić, 2016, p. 11). Relating to the Croatia the Commission commented that the state had been experiencing excessive macroeconomic imbalances requiring decisive policy action and specific monitoring, while highlighting that the people at risk of poverty or social exclusion continue to represent a relatively large share of the population (European Commission, 2015a, p. 28).

5.2. Country Report Croatia

In its 2016 Country Report the Commission indicated that in 2015 Croatia finally came out of its six years-long recession. The results showed that between 2008 and 2014, GDP had shrunk by more than 12% in real terms and unemployment had surged from below 9% to more than 17%. The situation started to improve at the end of 2014, and in the course of 2015 real GDP growth had surpassed expectations. It was noted that under the Europe 2020 Strategy, Croatia had been performing well relative to some of its national targets, while more effort had been needed with others. Croatia was performing well on the employment rate, reducing greenhouse gas emissions, renewable energy except transport, early school

leaving, tertiary education attainment, and reducing poverty and social exclusion, but more effort has been needed in R&D investment, renewable energy in transport, and energy efficiency (European Commission, 2016. p. 1-2). One of the findings of the IDR showed that the unemployment rate had remained very high, especially for youth and the low skilled. Also, it was highlighted that the education and social protection systems still had suffered from structural weaknesses (European Commission, 2016. p. 3). The Commission underlined that in 2015 expenditure on active labour market measures (ALMPs) still had amounted to only 0.5% of GDP, the coverage has been 10% and the targets for new beneficiaries had not been met. ALMPs continued to focus primarily on highly educated young people without working experience. The two measures most used in 2015 were subsidies for hiring and "occupational training without commencing employment", both of which seem to be showing their first positive effects. Additionally, the activation of the long term unemployed was still inadequate (European Commission, 2016, p. 81). Regarding the social protection system outcomes, the Commission indicated that the levels of poverty and social exclusion had been high. This was partly explained by low expenditure on social protection which in 2013 had stood at 21.7% of GDP, well below the EU average of 28.6% of GDP in 2012. Particularly the unemployed, inactive and single people were at high risk. The situation of the elderly, especially women, but also of households with three or more children was substantially worse than the EU average. Further, the eligibility criteria for social protection benefits were inconsistent. The Guaranteed Minimum Benefit scheme (hereinafter: GMB) was not adequate to cover basic subsistence needs. The base amount of the GMB, operational since January 2014, has been set at 800 HRK (105 EUR) for a single person while the poverty line is 1 980 HRK (260 EUR, or 60% of the median income). However, the levels of social assistance benefits are still not linked to any reference value or relevant indicator. The Commission concluded that some steps had been taken to improve the adequacy and expand the coverage of social assistance. This referred to the amendments to the Social Welfare Act increased the GMB for single persons not capable of work and for single parent households with children by 15% and also to the benefit for 73 000 vulnerable energy consumers (European Commission, 2016, p. 85).

5.3. National Reform Programme

The NRP 2016, prepared by the Croatian Inter-Agency Working Group, described the measures that were already taken or shall be taken by the Croatian Government within the next 12 to 18 months in order to achieve sustainable economic growth, job creation and the creation of better opportunities for Croatian citizen. The Government set two main objectives for structural policies in 2016 and 2017: increasing the sustainability of the general government debt and promoting growth and employment in the Croatian economy. Also it set four specific key reform areas that stand out within these main objectives: 1) macroeconomic stability and fiscal sustainability; 2) easier business conditions and better investment environment; 3) greater efficiency and transparency of the public sector; 4) better education to respond to the labour market (Republic of Croatia, 2016, p. 5). Most of the NRP dealt with the implementation of the 2015 Council Recommendation for Croatia. Two recommendation will be mentioned, one concerning the pension system and other concerning the wage labour market and social benefits system. The Council recommended to the Croatia to discourage the early retirement by raising penalties for early exits and to improve the adequacy and efficiency of pension spending by tightening the definition of arduous and hazardous professions. The Republic of Croatia reported that the reduction of opportunities for early retirement in the past period had been primarily addressed by measures to reduce disability pension, namely by implementing new process to determining disability. The reduction of a number of new disability pension beneficiaries was noticeable: 3,475 on 2014 and 2,101 in

2015. Also it reported that the revision of the existing list of profession and job positions to which pensionable service with extended duration is applied had been conducted, with the purpose of decreasing the number of such professions by 50% (Republic of Croatia, 2016., p. 15). Another recommendation emphasized the importance of the removal of the weaknesses in the wage setting framework; the necessity to strengthen incentives for the unemployed and inactive to take up paid employment and also to carry out the reform of the social protection system and further consolidate social benefits. The Republic of Croatia answered that it is to be expected that the "Study of the impact of minimum wage", containing numerous statistical data, will become the basis for future policies and regulatory solution. The intended activity aims to establish a working group in order to assemble all relevant stakeholders. Also, it reported that the Action plan for establishment and regulation of the wage system in the Republic of Croatia 2015-2016 has been adopted and had provided continuous monitoring of the collective bargaining process in public and civil services, with the objective to develop a framework for the Commission for development of human resources in public administration (Republic of Croatia, 2016., p. 18). Considering the social benefits, it was reported that the comprehensive analysis of the social protection system had been completed. Analysis results have determinate 28 benefits at national level ad 2907 benefits with social component at local level. Also, this analysis showed that there had been a lack of uniform criteria for their award, namely certain benefits require verification of income and assets, some require only verification of income and others do not require any verification of income or assets. Proposals of measures arising from the said analysis will be integrated in the reform measures to be implemented in 2016 and 2017, especially by introducing the financial status verifications and criteria for benefit awarding, by reducing abuse or the removal of overlapping, duplication or accumulation of right in the allocation of benefits and services on different level of government. Regarding the consolidation of social benefits trough the One Stop Shop, the Act of Amendments to the Social Welfare Act was adopted, regulating the administration of the guaranteed minimum benefit by competent state administration offices in counties or the competent office of the City of Zagreb. Finally, it was reported that the amount of guaranteed minimum benefit for singles - incapacitated adults, as well as children of single parents and children from single-parent families had been increased (Republic of Croatia, 2016., p. 19). In the second part of the Report, the main objectives and reforms areas in 2016 and 2017 was presented, which also includes the areas of healthcare, pension and social benefits systems. Concerning the social benefits systems following measures were implied: 1) consolidation of benefits in the social welfare system on a national level; 2) establishing a single centre for social welfare benefits with integrated data and benefit administration; 3) prescribing a guaranteed minimum standard; and 4) improving and strengthening professional work activities, all in order to increase the efficiency, transparency, flexibility, fairness and sustainability of social benefits system. Those reforms will be based on the standardisation of criteria for the allocation of social benefits and the systematic introduction of means test and income thresholds by introducing the social benefits records and the easier administrative processing of social benefits (Republic of Croatia, 2016., p. 41-42).

5.4. Council Recommendation on the 2016 NRP of Croatia

As it was noted in the Council Recommendation, the Croatian NRP had presented a fairly ambitious reform agenda, which, if fully implemented within the indicated timelines, would help address its macroeconomic imbalances. It outlines relevant measures to improve the management of public finances, the health sector and the business environment and commits to ambitious reforms in the public administration, the pension system, social protection and the improvement of governance in state-owned enterprises (European Commission, 2016, p.

3). Still, the Council once again stressed that a large proportion of the working age population had not been participated in the labour market due to the early retirements and high unemployment and that there had been regional differences in per capita spending on social protection and inconsistencies as regard the eligibility criteria for general social protection schemes and those targeting special categories (European Commission, 2016, p. 5). Commission set out five recommendations for the Croatia to take action in 2016 and 2017. Among the other, to take measures to discourage early retirement, accelerate the transition to the higher statutory retirement age and align pension provisions for specific categories with the rules of the general scheme, by the end of 2016; to provide appropriate up- and re-skilling measures to enhance the employability of the working-age population, with a focus on the low-skilled and the long-term unemployed and to consolidate social protection benefits by reducing special schemes, aligning eligibility criteria, integrating their administration, and focus support on those most in need (European Commission, 2016, p. 7).

5.5. First results of the European Semester 2016

The early results of the European Semester can be seen from the Commission's Country Report Croatia 2017 in which was noted that the Croatia had made limited progress in implementing the 2016 country-specific recommendations, due to the two general elections in less than a year. In relation the Council's recommendation mentioned in the paragraph above, the Commission stressed that there had been no progress in discouraging early retirement and that the limited progress had been made in providing appropriate up- and re-skilling measures, while there had been no progress in consolidating social protection benefits. It was stressed that the unemployment rate had been falling rapidly, thanks to moderate job creation but also a shrinking labour force**.** In 2016, the unemployment rate fell to 12.8 %, over 3.5 percentage points below the rate a year earlier. Still, this was mostly a result of the temporary contracts, while the youth and long-term unemployment remain high. Croatia still exhibits high levels of poverty and social exclusion, and the two successive personal income tax reforms have reduced the tax system's capacity of tackling income inequality. Inconsistencies, fragmented coverage and lack of transparency in the system of social protection weaken its effectiveness and fairness. Finally, both current and future adequacy of pensions is low and creates high risks of poverty in old age, especially for those with shorter working lives (European Commission, 2017, p. 1-3).

6. CONCLUSION

Well designed welfare systems combining a strong social investment dimension increase the effectiveness and efficiency of social policies, whilst ensuring continued support for a fairer and more inclusive society. The EU introduced the social investment perspective by adopting the ten-year strategies. The first one, Lisbon Strategy had been governed trough the OMC, method based on the interactive benchmarking of national progress towards common EU objectives and organized mutual learning. Although it gradually developed into overly complex agenda with results weaker than expected, the European Council insisted that a continued EU-level commitment to structural reforms and social cohesion will be needed after 2010. Europe 2020 brought in a new and better coordination between various EU and Member State actors, while it introduced new mechanisms aimed at higher policy convergence. The Europe 2020 Strategy revised the system of governance by implementing a new structure for the supervision and consolidation of Member States, the European Semester. The EU preference still remained to adopt soft packages and platforms for social initiative, as opposed to hard law mechanisms. The effect of that kind of mechanism can be seen trough the example of CSRs. To be specific, trough theirs NRPs and SCPs the Member States report on the specific policies they are implementing and intend to adopt and on their

concrete plans to ensure compliance with the EU's recommendations. Afterwards, the Commission assesses these programmes and proposes CSRs which cover wide range of policy issues, including fiscal, budgetary, economic, employment reforms and also the wage determination, education, pensions, health care, poverty and social inclusion. By doing so, the EU interfere deeply into policy areas which fall within the primary competence of Member States, where Union legislation is often prohibited under the Treaties. It is clear that such European Semester kind of governance is long lasting and does not produce the quick result. Besides, by building and governing such a strategy it is hard to predict the global financial contingencies, as it can be seen from the Lisbon Strategy scenario. The overview of the 2016 European Semester on the example of the Republic of Croatia had showed that governance of the EU's social policy, namely the progress in the field of social policy can be delayed due to the internal political instability. Despite the slowness and susceptibility in actions the results had showed that EU's social policy could reach to the legal systems of the Member States in its own specific dynamics. Considering the content of EU's social policy, which in most aims to contribute the general well-being, it is inevitable to produce some positive effects at the EU level and Member States level, in extent that still deepens on political will of each individual Member State.

LITERATURE:

1. Babić, Z., Baturina, D. (2016). Koncept socijalnih investicija kao odgovor na krizu i nove izazove socijalne države: trendovi i perspektive. *Revija za socijalnu politiku*, 23(1), 39-60.
2. Barnard, C. (2010). The Shaky Legal Foundations for Institutional Action under the Employment, Lisbon and EU2020 Strategies. *Cambridge Yearbook of European Legal Studies*, 12, 1-34.
3. Dinan, S. (2015). Tracing the European Union's Social Policy: The Social Investment Perspective. *The European Consortium for Political Research (ECPR)*. Retrieved 19.05.2017 from https://ecpr.eu/events/paperdetails.aspx?paperid=25014&eventid=94.
4. European Commission (2009). *Consultation on the Future „Europe 2020" Strategy*. COM (2009) 647 final.
5. European Commission (2010). *Europe 2020 – public consultation. Overview of responses*. SEC(2010) 246 final.
6. European Commission (2010a). *Communication from the Commission Europe 2020. A strategy for smart, sustainable and inclusive growth*. COM(2010) 2020 final.
7. European Commission (2010b). *Governance, Tools and Policy Cycle of Europe 2020.* Retrieved 04.05.2017. from http://ec.europa.eu/europe2020/pdf/annex_swd_implementation_last_version_15-07-2010.pdf
8. European Commission (2013). *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Towards Social Investment for Growth and Cohesion – including implementing the European Social Fund 2014-2020*, COM(2013) 83 final.
9. European Commission (2015). *Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of Regions and the European Investment Bank. Annual Growth Survey 2016. Strengthening the recovery and fostering convergence*. COM(2015) 690 final.

10. European Commission (2015a). *Report from the Commission to the European Parliament, the Council, the European Central Bank and the European Economic and Social Committee. Alert Mechanism Report 2016*. COM(2015) 691 final.
11. European Commission (2016). *Commission Staff Working Document. County Report Croatia. Including an In-Depth Review on the prevention and correction of macroeconomic imbalances.* SWD(2016) 80 final/2.
12. European Commission (2016a). *Council Recommendation on the 2016 national reform programme of Croatia and delivering a Council opinion on the 2016 convergence programme of Croatia*. COM (2016) 331 final.
13. European Commission. (2017). *Commission Staff Working Document. Country Report Croatia 2017. Including an In-depth Review of the prevention and correction of macroeconomic imbalances*. SWD(2017) 76 final.
14. European Council. 2008. *Brussels European Council 13/14 March 2008 Presidency Conclusion*, 7652/1/08, REV 1.
15. European Council. 2000. *Lisbon European Council 23-24 March 2000. Presidency conclusions*. Retrieved 07.05.2017 from http://www.europarl.europa.eu/summits/lis1_en.htm.
16. Eurostat. 2016. Smarter, greener, more inclusive? Indicators to support the Europe 2020 Strategy. Retrieved 07.05.2017 from

    http://ec.europa.eu/eurostat/documents/3217494/7566774/KS-EZ-16-001-EN-N.pdf/ac04885c-cfff-4f9c-9f30-c9337ba929aa.
17. Zeitlin, J., Vangercke, B. (2014). Socializing the European Semester? Economic Governance and Social Policy Coordination in Europe 2020 (Research report No. 7). *Swedish Institute for European Policy Studies*. Retrieved 04.05.2017 from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2511031.
18. European Parliament (2014). *The Open Method of Coordination. European Parliamentary Research Service*, Retrieved 27.4.2017 from http://www.europarl.europa.eu/EPRS/EPRS-AaG-542142-Open-Method-of-Coordination-FINAL.pdf.
19. Republic of Croatia (2016). *National Reform Programme 2016*. Retrieved 07.05.2017 from http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_croatia_en.pdf.
20. Samardižja, V., Butković, H. (2010). From Lisbon Strategy to Europe 2020. An introduction. In Samardžija V., Butković, H. (eds). *From the Lisbon Stratefy to Europe 2020*. 4-27.
21. Samardžija, V., Jurlin, K., Skazlić, I. (2016). *The Significance of the Semester for Economic Policy Reform in Croatia and Selected New member States*, Institute for Development and International Relation. Retrieved 15.05.2017 from http://polocro28.irmo.hr/wp-content/uploads/2015/10/POLO-PP-ESemestar-EN-FINAL-za-web-1409-1.pdf.
22. Szyszczak, E. (2006). Experimental Governance: The Open Method of Coordination, *European Law Journal*, 12(4), 486-502.

PRELIMINARY CONCEPT OF EDUCATIONAL SOFTWARE MODELLING

Mila Nadrljanski
Maritime Faculty, Split, Croatia
mila@pfst.hr

Veronika Domitrovic
University College of Inspection and Personnel Management
Split, Croatia
veronika.domitrovic@icloud.com

Djurdjica Vukic
University College of Inspection and Personnel Management
Split, Croatia
durdica@vsikmp.hr

ABSTRACT

Earlier e-learning concepts were mere copies of conventional learning concepts. That triggered authors to structure a model of educational process on other grounds, those based on knowledge systematized through concepts, processes, values and facts. The Concept implies a viewpoint which reflects essential properties of the objects to be studied. The Processes are a set of interrelated activities focused on realization of a given objective. The Values are standards of behaviour and existence which are personally or socially preferable as opposed to the inverted pattern of behaviour or existence. The Facts are objectively verifiable reality. The basic concept is modelling of educational software customized to the user. According to the conceptual model of the author, the first requirement for customization is to define a user model. A user model is a mental picture of cognitive possibilities of a user based on the type of personality. There are different interpretations of personality typology that can be found in literature. The authors have adopted the ten personality type classification by Jean Piaget as a basis for the proposed modelling of educational software, customised to the type of personality, for the purpose of acquisition of knowledge, skills and habits in the most efficient manner.

Keywords*: e-learning, educational software, personality types*

1. INTRODUCTION

Development of "information society" facilitates accessibility to data, information and knowledge – and that is why education should capacitate everyone to collect data, make selection, evaluate and use information in the process of learning and formation of knowledge. Therefore education must be constantly adjusted to changes in society; it must lay the foundations of capabilities and enrich it with human experience. This paper gives an overview of the process of acquiring knowledge which can be applied to both traditional i.e. human acquisition of knowledge, which is analysed in the philosophical literature, as well as to mechanical acquisition of knowledge, which is recently the subject of computer science, information science and other sciences. Meanwhile, a lot of information has been collected about teaching and learning with the use of digital media. Software used in the field of education implies an intellectual technology and is called educational software. It includes programming languages, tools and organization of teaching and learning which is based on logic and pedagogy. Therefore, the term educational software relates to both ready-to-use computer programs, which can be used in teaching, as well as programs which assist and guide in individual learning stage.

Yet there is still a substantial need for basic research. In that sense, the study of learning with the help of digital media should not only focus on the outcomes of the learning process, but more on learning itself. The starting point of the research should be the question of the extent to which digital media are adequate means to achieve the objectives and which side effects you should pay attention to. There is another research assignment outside certain educational institutions which refers to the phenomenon of particularly young people dealing with future technologies. This is a fundamental type of research and it might be able to provide important impulses for the intense involvement of digital media in education and leisure time, as well as for development of digital media themselves. In contemporary education it is necessary to make a shift from the model of reproduction of knowledge towards the model of knowledge construction, which considers teachers and students as partners in the joint construction of the knowledge base that has to be adopted. That knowledge base is being discovered and supplemented in the teaching process, while various sources of information are used, and a teacher has the role of students' mentor in teaching process.

However, currently most of communication in teaching and applied technology relies on information products, and not on the information process. Computers and interactive technology enable students to browse, explore and structure environment in which they can organize and interpret the data for themselves. Knowledge acquired that way is not a mere collection of facts, but a process, i.e. the way of thinking or establishing connections, and therefore, the strong flexible structure of relations.

2. STRUCTURAL COMPONENTS OF E-LEARNING MODELLING

“Information society” development facilitates accessibility to data, information and facts – and that is why education should capacitate everyone to be able to collect data, select and evaluate them and finally use them. This brings about the need to adapt to changes in society and lay the foundations of its capabilities. The main emphasis is on transfer of rather extensive general knowledge and the possibility of linking it with selected vocational subjects. Education should, therefore, constantly be developed. The result of education is the formation of knowledge, building of skills and creating habits. It is not easy to define the concept of knowledge. Different social groups may have different concepts of knowledge and even within the particular social group you can find different views on knowledge and ignorance. “Knowledge 1 is a system and logical overview of facts and generalizations depicting objective reality that are acquired to be permanently retained in consciousness; a collection of facts, information, and skills acquired by training or experience in order to be able to solve problems theoretically or in practice”. At first we will neglect the issue of content, which is due to one reason or another called knowledge (or ignorance), and focus on the problem of structuring knowledge. It seems that everyone accepts the statement that knowledge is a network of beliefs connected with logical links. Yet every logically correct network of beliefs is not called knowledge. Concerning philosophers from long ago and contemporary as well, from widely accepted beliefs in the network of beliefs, one characteristic has been required: a network of true beliefs. Human knowledge is constantly increasing, and there has always been the question of how to shape, comprehend and systematize it. Francis Bacon 2, an English philosopher from the 16th century, whose famous phrase is “knowledge itself is power”, emphasized the need of categorization and classification of knowledge in natural and social sciences in the same way. An English pedagogue Bloom 3 also dealt with taxonomy of knowledge in terms of setting educational goals. Educational goals (knowledge, skills and habits) have been systematized in different taxonomies (Figure 1).

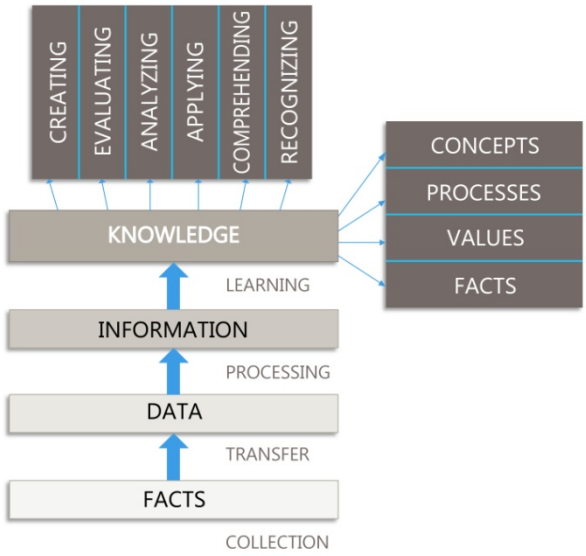


Figure 1 - Model of combining taxonomy of knowledge and educational content structure (original work of the author)

Taxonomy is about the classification of educational goals at different stages of use. It displays a hierarchical classification of the complexity from the simple to the complex, and from the concrete to the abstract. Bloom and his collaborators have classified the educational goals from the cognitive area into the following six categories: Remembering, Comprehending, Applying, Analyzing, Synthesizing, and Evaluating.

The area of artificial intelligence is the first area which introduces knowledge resources into the arena of "mechanical handling" with the intention of making computers able to perceive and apply knowledge in the same way that a human does. Unlike other branches in the field of computer science which deal with the study of algorithmic methods for the purpose of solving certain problems, artificial intelligence is focused on manipulation of symbols in the procedures of solving problems, trying to emulate behaviour of human brain in these situations. The process of acquiring knowledge meets all the requirements to announce its candidacy for the primary problem of Information Science. So far, there are relatively few studies that have explored the concepts of learning style associated with the effects of multimedia applications and which could provide empirical contribution to the mentioned assertion. Some of these studies will be the subject of future studies dealing with the evaluation of intelligent tutoring systems and hypertext systems, where it will not deal with the question of what kind of a learning style construct is taken as the basis for research. In this paper we present the concept of knowledge structure based on levels according to the criteria of their sustainability and significance.

3. STRUCTURING OF KNOWLEDGE

The scientific approach to the study of any phenomenon requires its clear and precise distinction from similar or related phenomena. This makes us obliged to provide an explanation and interpretation of the new terms used in this chapter, in which we deal with the concept of level structure, and above all the terms of **concept**, **process**, **value** and **fact**. Every presentation of knowledge has its own structure (which should be solid) or assumes structuring in order to facilitate users to find their way in this rather unknown environment more easily. Modern age is characterised by growing knowledge society which has a major role as an instrument of knowledge organization.

Concepts

The word “concept” is used differently, sometimes in psychological, sometimes in a logical sense, and sometimes even in a vague mixture of the two. When there is such freedom, it finds its natural limit in the need to stick tightly to the accepted usage 4. A concept is a fundamental factor which is used in the scientific and technical literature in a similar way as in everyday language to indicate the thought processes that lead to solutions, ideas, artistic forms, theories or products that are unique and new.

Every feature of the concept that is specified in the definition is necessary, and all the features together should be sufficient to clearly and accurately describe the concept. A concept can often be defined in several ways. All definitions of the same concept must be mutually equivalent, i.e. they have to define the same set of objects. There are two types of concepts: basic concept and derived concept 5. Concepts indicate the contents on which learning objectives of certain content are realized. Intelligibility (definition of the concept range) is particularly important feature of a concept and therefore concepts are considered intelligible when their scope is fully understandable, whereas they are called vague when their content is only partially understood. Adopted concepts often have meanings that are not entirely adequate, they lack width or ability to move into different contexts. Concepts are forms of thinking; they are different by their existence and development of human cognitive actions. That is why the concept formation is explained by cognitive activities (operations, functions) of a man. Hence the conclusion that concept formation in the process of acquiring knowledge should be organized as students’ an intensive cognitive activity in terms of applying various cognitive operations, for example: analysing, separation, enumeration, differentiation, identification, confrontation, systematization, classification, subordination, superimposition, synthesizing, etc. In the entire process of concept formation there are two fundamental merging processes: inductive and deductive, i.e. diverting from individual to the general and vice versa, but considering that individual is always expressed in general. Besides, this dynamic process of concept formation from its beginning, through a content widening and deepening up to the generalization of the highest degree, takes place in dialectic, uneven transitions, in other words, quantitative merging of new tags determines constant qualitative change of a concept.

Processes

... nowadays knowledge is more and more seen as a process, not as a state.

J. Piaget 6

Defining the very concept of “process” is also the subject of numerous scientific debates and interpretations. Some of them are important for presented approach to systematization of knowledge. There are several definitions of the term "process". It is a set of interrelated, interacting activities which transform inputs into outputs (ISO 9000:2000.). Process is a set of interrelated activities where any set, regardless of the area and the scope of action, corresponds to the definition of a process, and each process is composed of other processes, so even a single interaction may be called a process. Process is a set of activities and/or operations that convert certain inputs into outputs. Process is identified by changes that occur in the course of activities and operations. Results of these changes are outputs. Every process has users and other interested parties (which may be internal or external), with certain requirements and expectations concerning the process and which define required output elements of the process.

Contemporary view on the study of the system is based on the process approach. The process itself consists of several stages through which, depending on professional knowledge, professional profile, as well as motivation, one acquires knowledge. Learning is a process of acquiring relatively lasting changes of a subject, and they are the result of subject’s mental activity. The change stimulates subject’s change in behaviour in situations requiring scientific

behaviour. Mental activity consists of mental processes. Mental processes, by means of which learning takes place, are cognitive (perception, thinking and memory) and emotional. This means that learning process is not a separate mental process but is composed of cognitive and emotional processes to which psychological features of the subject respond and through which they change.

Values

In a broader sense it refers to everything that can be estimated as positive. It denotes positivity of something, its character of goodness that is capable of attracting people's respect and encourages them to act 7. In philosophy (i.e. axiology), this is the term used to designate aims, regulatory principles, aspirations or achievements, deeds of ethical, cognitive or aesthetic and artistic nature (truth, beauty, goodness, etc.) 8. In psychology, values are general and individual aspirations for achieving goals that are considered attractive, desirable or acceptable, or they are perceived as right and good, and are also characterized by a process of socialization. They may contain opinions about what is useful, advantageous, i.e. may be utilitarian in basis. If such an attitude is particularly present in the system of values, i.e., in the value orientation of an individual, then they grow from personal needs, desires and personal priority goals, and therefore may not be generally accepted and assessed as socially desirable. However, there are some general values that are in line with social norms and culture, such as justice, freedom, equality, honesty, etc., where their ethical side and social acceptability is more pronounced 9. It is difficult to define values. They always occur in pairs: good-bad, beautiful-ugly, true-false, harmful-useful etc. The pairs can sometimes reverse, so what was good yesterday, today is bad, what used to seem useful, has become harmful. In fact we express an opinion about something and therefore valuable attributes fall into rational category. Mental momentum is also significant here: we make a choice or take a stand. All of this shows that every evaluation is an extremely complex process which depends on a large number of moments. Regardless of that, values are neither arbitrary nor subjective. There are universal standards for determining values. Values, as patterns, are a factor of establishing and regulating interactions between protagonists and objects in educational process. Some scientists think they have the following characteristics:

- *stability* - which means that values are a relatively lasting feature of human consciousness. If they were unstable and invariable, the continuity of human personality and society would be impossible;
- *selectivity* - manages the choice between different options, modes and objectives of an activity;
- *desirability* - determines what should be desired and done;
- *positivity* – values, as opposed to attitudes, we cannot discard, but accept to varying extents; otherwise they cease to be regarded as a values;
- *intersubjectivity* - values occur as a result of regulation of an interaction between people;
- *value is a belief* - and like any other belief it includes cognitive, affective and conative component.

Values are certain categories of human consciousness which essentially affect our behaviour and our attitudes towards the world. A man is guided by "the model of the world", "the image of the world" that was created in a given environment. With the value category one chooses impulses and impressions that emanate from the outside world, and turns them into facts of experience. Using value categories, one chooses impulses and impressions that emanate from the outside world, and turns them into facts of their own experience. Therefore, a more advanced classification of values involves observing a few essential relations of man towards the world in which he lives, forms of experiencing the world:

- relation of man towards nature (subordination, management, harmony, nature protection);
- different views on human nature (good, evil, neither good nor evil, depending on the social and cultural circumstances and individual efforts);

- attitude towards the social dimensions of time (past, present and future orientation, orientation to their totality, to change, motivation, tradition);
- relation towards other people (kinship-ethnic amalgamation and collectivist bondage, individualization, egocentrism, solidarity);
- attitude towards the activity (passive suffering and fatalism, neutral accommodation, cooperation, pragmatism, competition, non-conformism, visionary perception, conflict, confrontation);
- attitude towards expectations (pessimism, optimism, realism).

Facts

A fact is something that can be undeniably established. In establishing facts it is necessary to apply an objective approach, which in science has to be supported by exact evidence. In philosophy, a rational method with impartial checking and without interference is necessary. In establishing facts, no personal attitude or any prejudice should interfere 10. A fact is defined or definable existence of the object, or relations between objects of our cognition 11. When the facts are defined as undeniable and applicable general truths, while interpretations are defined as different views, explications or exploring possibilities (e.g. an interpretation of what is important) there is a question of what are facts used for, and why they are necessary. But despite freedom and dominance of interpretation and own construction, there are universal facts which are not to be contradicted. Personal interpretation may be subjected to criticism and questioned because it is personal. Facts do exist, regardless of the user, but interpretation is the basis of individual construction of the world and conduct of life.

4. CONCLUSION

Major auditing of the content of scientific and technological education within the curriculum is commonly performed every 5 or 10 years, according to some international standards. Changes in science and technology are so fast that the newly adopted curriculum is already outdated by the time it is put into practice. Textbooks have about the same life span and experience the same fate. However, some parts of science evolve much more slowly. Of the four types of knowledge discussed in this paper, concepts and processes in science form the core which changes slowly. Values for estimating veracity of scientific facts and for assessment benefits of the concepts and procedures are also quite stable. The form of a fact itself changes rapidly. Value, as the basis for evaluation of convenience of content in scientific and technological activities, now begins to initiate some undesirable effects of development that were supposed to be useful. As parts of the curriculum change at a different pace, thus it is possible to make a simple correction of the factual content of a course, leaving only the core intact as it consists of concepts, processes and values. Some parts of the content may be excluded, reorganized or presented in a much more attractive form. Then, with the help of new technologies, students should be allowed to develop and understand the entire system of nature more comprehensively, and become more engaged in construction of theories and designing of practical solutions. If students are granted direct access to information and enabled to directly share their views with other students around the world, the curriculum could take on a new meaning and relevance.

LITERATURE:

1. Leksikografski zavod Miroslav Krleža: Enciklopedija
2. Hrvatska enciklopedija, F. Bacon, http://www.enciklopedija.hr/Natuknica.aspx?ID=5105
3. Agencija za odgoj i obrazovanje, Bloomova taksonomija, http://www.azoo.hr/images/razno/BLOOMOVA_TAKSONOMIJA.pdf
4. Gottlob Frege, Osnove aritmetike i drugi spisi, Kruzak, Zagreb, 1995.str.195.

5. M.Nadrljanski: Znanstveno-eksperimentalna zasnovanost obrazovanja u elektroničkom okruženju - doktorska disertacija: Metodološko- metodički model obrazovanja u elektroničkom okruženju, Sveučilište u Zadru 2006.
6. S. Papert, http://www. time. com/time/time100/scientist/
7. Udruga za promicanje filozofije, http://www.filozofija.org/rjecnik-filozofskih-pojmova/#V
8. Hrvatski leksikon 2016.
9. http://www.enciklopedija.hr/natuknica.aspx?id=65496
10. https://hr.wikipedia.org/wiki/%C4%8Cinjenica
11. http://www.hrleksikon.info/definicija/cinjenica.html

DETERMINANTS OF SPREAD AND MEASURING FINANCIAL PERFORMANCE OF GOVERNMENT STAFF PERSONAL LOANS

Mohammed Hariri Bakri
Universiti Teknikal Malaysia Melaka, Malaysia
hariri@utem.edu.my

Shafinar Ismail
Universiti Teknologi MARA,Melaka, Malaysia
shafinar@bdrmelaka.uitm.edu.my

Baharom Abdul Hamid
International Centre for Education in Islamic Finance (INCEIF),
Kuala Lumpur, Malaysia
baharom@inceif.org

Alias Radam
Universiti Putra Malaysia, Serdang Selangor
alias@econ.upm.edu.my

ABSTRACT

Malaysian firms have been reported to involve in Asset-Backed Securities since 1986s where Cagamas is a pioneer. This research aims to examine the factor of influencing the primary market spread and measure financial performance of RCE Marketing as case study. Ordinary Least Square (OLS) regression analysis are applied for the study period 2007-2012. The result shows two determinants influence or contribute to the primary market spread and are statistically significant for the case study for RCE Marketing. The financial performance shows that this company is resilient during global financial crisis. RCE Marketing also shows better profitability capacity and dividend payments to their investors.
Keywords: *Financial Performance; Dividend Payments, Primary Market Spread*

1. INTRODUCTION

Asset-Backed Securities (ABS) were introduced by the United State government for housing loan funding program back in the 1970s and followed by other securities such as credit card and mortgage. It has become one of the financing tools after 1980 and it is widely spread all over the world. In Malaysia, the Tresor Asset Berhad a personal loan financing body that formed based on Fannie Mae and Freddie Mac on USA model. This personal loan financing was formed backed from 2007. RCE Marketing acts as an originator and its 100% subsidiary, Tresor Asset Berhad as a Special Purpose Vehicle (SPV), as an intermediary between long term investors and personal loan financing whereby it issues financial instrument to capital market players. This study focuses on Malaysia as one of the developing securitization market.

In 2001, the Securities Commission (SC) released its *Guidelines on the Offering of ABS;* that had paved the way for a CBO issuance by Prisma Assets Berhad, backed by a pool of Ringgit-denominated bonds. Another CBO transaction backed by corporate bonds and a CLO backed by rehabilitating corporate loans followed suit the same year. Till December 2009, an estimated 74 structured transactions have been approved under the SC‟s guidelines on private debt securities, ABS and other structured products, encompassing an array of asset classes. Malaysia also had grown its Islamic financial instrument, sukuk from US$1.5bil (RM4.8bil) in 2001 to more than US$148bil (RM473.7bil) in June2012. This accounted for 60.4% of the

outstanding global sukuk (Fong, 2012). Since 1970s, there are many extensive literatures on factors that impact the pricing of corporate bond. In contrast, little research has been done on the determinants the impact the pricing of asset backed securities in most developed countries; including Malaysia as known as a major sector of the bond market (Fabozzi & Vink, 2012). In United Kingdom, RMBS offered the largest securitization sector and many empirical evidences on the factors that impact the new issue on pricing. of RMBS has been published. In Malaysia Tresor is the key player for financing personal loan to government staff but not much research has been written on the determinants of primary market spread. Spread is the premium or yield that investors demand above a reference rate. In predicting the CMBS loan performance (Seagreves, 2012) should include additional information on loan originators such as type of firm as well as the extent to which originators retain an equity stake in target CMBS. Therefore, this study is to fill in the research gap by exploring the determinants of primary market spread in Malaysia by focusing on Tresor; which is very successful evenduring the financial crisis.

2. LITERATURE REVIEW

There are inconclusive findings on sample less variation of types of originators and nature of underlying assets in other markets in comparison with euromarkets. The question whether these other markets are less advanced than euromarkets remains unanswered. It has been demonstrated that the determinants of primary market spreads are relevant for different financial market participants, previous researchers Vink (2007) found out that default and recovery risk characteristics represent the most important group in explaining loan spread variability. Within this group, the credit rating dummies are the most important variables to determine loan spread. Meanwhile, The finding from the research suggest that an investor must not rely only on certain factor such as credit rating but there is other more relevant factors which is related to the spread (Fabozzi &Vink, 2012). Investors must not depend absolutely on the credit rating even though credit rating most significant variable in determining spreads but many other factors such as enhancement, nature of asset, loan to value, no of trenches, time of issue and many others.

2.1 Profile of RCE Marketing for Financing Personal Loans

RCE Capital was incorporated in Malaysia on 18 December 1953 as a limited company under the name of Leong Tian Tin Mines Limited. On 15 April 1966, the Company changed its name to Leong Tian Tin Mines Sdn Berhad. The name was later changed to Rislee Enterprise Sdn Berhad on 7 December 1978 before adopting the name Rislee Enterprise Bhd on 18 August 1993 to reflect its conversion to public limited company. Subsequently on 25 September 1993, the Company changed its name to Rediffusion Berhad before assuming its present name on 9 October 2003 to RCE Capital Berhad. RCE Capital is a 43.4%-associate company of Amcorp Group Berhad. On 20 Sep 1994 the company was listed on the Second Board of Bursa Securities and later shifted to the Main Board (now known as Main Market) on 23 Aug 2006. RCE Capital's subsidiaries are now involved in financial services following the acquisition of RCE Marketing Sdn Bhd (RCEM) and the sale of the broadcasting business, both in 2003. In early-2007, RCE Capital bought into AMDB Factoring (renamed RCE Factoring), which provides credit factoring solutions to the manufacturing, construction, information and communications technology and services sectors. Tresor Asset Berhad issue the first tranche of RM100 million from the total of RM1.5 billion Asset Backed Securitization. This 5.5-year program is secured against RCEM’s pool of loan receivables and is accorded AAA-rating by RAM Ratings Berhad. RCE Marketing has issue one of the biggest ABS in 2007 through its SPV in terms of total issue size.

RCE Marketing is a financing entity that gives personal loan to government staff through KOWAJA one of the cooperative in Malaysia and therefore operates personal loan securitization for promoting the secondary mortgage market. As such, Tresor Asset Berhad as Special Purpose Vehicle was set up by RCE Marketing Sdn Bhd as wholly owned subsidiary which referred as an issuer of instrument. As for Tresor , its role is to be an intermediary between primary lenders and investors of long-term funds. Its function is very much similar to those of unit trust company but differs as Tresor will pool debts or personal loan that it securitized for issuance of the unsecured but highly rated debt securities. Interestingly, Tresor debt securities are seen to be assigned the highest ratings Rating Agency Malaysia and Malaysian Rating Corporation, the only two local rating agencies in Malaysia that denotes its strong credit quality of property market, and hence, researchers are motivated to study its financial performance during sub-prime crisis rooted in USA in 2007 and spread all over financial centers, including Kuala Lumpur, till 2012.

3. DATA AND METHODOLOGY

Previous researchers include Smith (1980), Edwards (1984), Boehmer & Megginson (1990), Booth (1992), Blackwell & Winters (1997), Eichengreen, & Ashoka (2000) has made empirical studies. The loan pricing tests we perform are most similar to those presented in Vink both in the actual model estimated and in the average size of loans under examination with additional new variable Liquidity and Leverage. According to the model explained in the equation 1 we could estimate the determinants of primary market spread. In order to allow for a comparison of the empirical results, the proxies we used to test which factors affect primary market spread are based on theory. We shall provide a brief explanation for each variable below. In line with previous research in this area, using White (1980) methodology would assist to determine the factor of influencing the primary market spread We employ standard OLS regression estimation techniques and adjust for heteros kedasticity The model estimated is:

$$y = X\ß + u \qquad (1)$$

This study focuses on how spread responds to the various variables specifically on Tresor as a case study. During financial crisis, Tresor still make handsomely profit compare to other market especially in United State of America which having problem with sub-prime mortgage. The SPREAD (primary market spread) represents the price for the risk taken on by the lender on the basis of information at the time of issue. In our sample, the spread is defined as the difference between the margins yielded by the security at issue above a corresponding benchmark. The benchmark is presented in basis points. According to Sorge & Godanecz (2004), these measurements of the spread for floating and fixed rate issues have become standard in the loan pricing literature. Only various adjustments and refinements are applied in different studies in order to capture the comparability of pricing variables across floating and fixed rate issues in a better fashion.

Daily spread basis points for the primary market spread are obtained from data-stream. The sample of data of transactions of primary market spread throughout 2007 to 2012. This research is also using hypothesis testing to test relationship between the dependent variable with independent variables. The dependent variable is SPREAD. Vink (2008) used SPREAD to test the determinants of cross sectional variation with systematic, marketability of financing and non performing characteristic of the loan The independent variables are number of tranches, loan size, maturity, loan to value, liquidity, leverage and year of issue. Table 1 shows the hypotheses for this study:-

Table 1 : Hypothesis

H_1**:**	Loan to Value is negatively related with primary market SPREAD
H_2:	Maturity is positively related with primary market SPREAD
H_3:	Loan Size is negatively related with primary market SPREAD
H_4:	Number of Tranches is negatively related with primary market SPREAD
H_5:	Liquidity is positively related with primary market SPREAD
H_6:	Leverage is positively related with primary market SPREAD
H_7:	Year of issue is positively related with primary market SPREAD

Lastly, a cross sectional regression analysis is applied to show the relationship between dependent and independent variables at one period or point in time. The determinants of a primary market SPREAD are examined through cross-sectional regression analysis. The general cross-sectional regression model as follows:-

SPREADi = αn + ß1 LOAN TO VALUEi + ß2 MATURITYi + ß3 LOAN SIZEi + ß4 # TRANCHESi + ß5 LIQUIDITY+ ß6 LEVERAGE + ß7 YEAR OF ISSUE + eit *(2)*

3.1 Findings for determinant of Primary Market Spread

Table 2 provides the result from the sample data by using the econometric views (STATA) statistical package by applying the based on Tresor securitization in Malaysia. The cross section regression model is spelt out as follows:-

SPREAD = 0.1929472 + -1.631196 LTV + 2.788655 MAT + -0.0614173 LOAN_SIZE + -0.0961168TRN + -1.296305 LIQUID + -0.1558607 LVG + 0.3781223 YR_ISSUE + eit *(3)*

The results show that the model as a whole perform well in terms of the joint significance of variables, F-value is 6.58 (Prob. > F=0.0002). In other word, the model is significantly fitted and this research has value to proceed. On the other hand, the average adjusted R^2 (66%) contribute explaining the variable.

Table following on the next page

Table 2 : Ordinary Least Square – The Results of Basic Model Parameter Estimates and Test of Significance for Determinant Primary Market Spread

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.1929472	4.864335	0.04	0.969
LTV	-1.631196	.7370947	-2.21	0.037***
MAT	2.788655	1.548056	1.80	0.085***
LOAN_SIZE	-0.0614173	.2513965	-0.24	0.809
TRN	-0.0961168	.5468087	-0.18	0.862
LIQUID	-1.296305	.3401624	-3.81	0.001***
LVG	-0.1558607	.3793468	-0.41	0.685
YR_ISSUE	0.3781223	.7058821	0.54	0.597
R-squared	0.667	F-statistic		6.58
Adjusted R-squared	0.5656	Prob(F-statistic)		0.0002
Sum squared resid	2.24362149			

***Significant level of 1%

At the level of the individual variable, loan to value has a negative relationship (Coefficient=-1.631196) with SPREAD whereby an increase in the number of loan to value would decrease SPREAD and statistically significant (prob. = 0.0037) at 1% significant level. This supports hypothesis 1 that the loan to value negatively related with primary market spread. Another variable is maturity has a positive relationship (Coefficient = 2.788655) with the primary market spread and statistically significant (prob. = 0.085) at 1% significant level. This result support hypothesis 2 that maturity is positively related to the primary market spread.

Based on other independent variables, LOAN SIZE has a negative relationship (Coefficient = -0.0614173) with primary market spread whereby an increase in number of LOAN SIZE would decrease SPREAD and statistically not significant (prob. t= 0.809) at 1% significant level. This support hypothesis 3 that the LOAN SIZE negatively related to determine primary market spread. TRN has a negative relationship (Coefficient=-0.0961168) with primary market spread and statistically not significant (prob. = 0.862) at 1% significant level. This result supports hypothesis 4 that TRN is negative relationship to the primary market spread. The other variable which is LIQUID has a negative relationship (Coefficient = -1.296305) with the primary market spread, and is statistically significant (prob. = 0.001) at 1% significant level. This result rejects hypothesis 5 that LIQUID is positively related to the primary market spread. The firm LEVERAGE has a negative relationship (Coefficient = -0.1558607) with primary market spread and statistically not significant (prob. = 0.685) at 1% significant level which is similar with the finding of Merton (1974).

This result rejects hypothesis 6 that the firm LEVERAGE is positively related to the primary market spread. The last determinant is YR_ISSUE. The YR_ISSUE has a positive relationship (Coefficient = 0.3781223) with primary market spread and statistically not significant (prob. = 0.597) at 1% significant level. This result support hypothesis 7 that YR_ISSUE is positively related to the primary market spread.

3.2 Findings for revenue and profits 2008-2012

Table 3 provides the result from the sample data by using the financial report from RCE Marketing . The analysis is spelt out as follows:-

Table 3 : Revenue and Profits 2008-2012 (RM '000)

Revenues and Profits	**2008**	**2009**	**2010**	**2011**	**2012**
Revenue	131,938	215,400	255,611	269,580	229,859
Profit Before Taxation	66,761	92,335	109,989	140,099	128,165
Net Profit	50,589	66,555	81,094	104,257	101,355
Earnings per Share (sen)	7.83	9.37	10.72	13.33	12.95

The revenue from interest income shows that kept on increasing every year but slightly fall 14% on 2012 from previous year it's and simultaneously with the profit before tax which is RM128 million consider stable since 2008 which that can be seen from the table above. In fact, during the financial crisis between 2008 and 2009 which is at the top of sub-prime mortgage crisis, the result from the table above showed that there was an increment in net profit of from RM51 million to RM 66 million in 2009, which is steady increase of of 29%. Fascinatingly, its net profits keep on increasing during uncertainties of financial crisis globally especially in the United States of America which seen many giant company collapse and has been bailed out by the US government during 2008-2009 periods. Other than net profit its earnings per share also record good earning at RM12.95 per share in 2012 from RM7.83 per share in 2008.

3.3 Findings for debt and profitability 2008-2012

RCE Marketing has a good track record of on income statement and financial position for the past five years as shown on following Table 4

Table 4 : Debt and Profitability Ratio

Type of Ratio	**2008**	**2009**	**2010**	**2011**	**2012**
Gearing Ratio (x)	3.04	2.47	1.83	1.51	0.89
Return on Average Shareholders' Funds (%)					
	24.37	22.32	19.36	23.25	19.15
Interest Coverage Ratio (Times)					
	3.01	3.99	3.94	3.61	3.56
Return on Average Total Assets (%)					
	5.18	5.19	5.26	5.87	6.76
Dividend Per Share (sen)					
	0.75	0.75	1.53	1.50	1.50
Net Tangible Asset (sen)					
	32.11	41.92	53.56	57.31	67.64

According the table 4 RCE Marketing had paid quite high dividend of 75 sen in 2008 and 2009 even though there was a subprime crisis during that time. Following strong financial performances for 2008-2012, its satisfactory returns on investment in funds and assets, its net tangible asset were increasing steadily from RM32.11 to RM67.64, a superb growth of 110%. As such, the net value of RCE Marketing is growing stronger even during global financial crisis, a strong testimony that RCE Marketing is a way forward to appeal banking institutions, insurance companies, asset management companies, as well as government funds and public companies to be its primary personal loan lenders.

The ability of RCE Marketing to have superb performance for both issues is testified by its key performance indicators. According RAM (2012) for cumulative net default rate for the underlying portfolio, Tresor Asset Tranche I stood at 3.61% which is very low default.

For cumulative repayment rate, Tresor Tranche I recorded at 36.22% since purchase date 2010 is consider good repayment with low average monthly net default rate at 0.16%. With its defaults and losses as well as prepayments of the personal loans shall continue to fall from year to year, RCE Marketing is seen capable to be alternative to the Bank Rakyat that provide financing personal loan to the government staff continuously and consistently.

4. CONCLUSION

Overall, the basic model used in this study to examine the relationships between the possible determinants with the primary market spread statistically significant for three variables. From seven hypotheses, two hypotheses supported; indicates that the determinants have a relationship with primary market spread. It can be concluded that maturity and year of issue significantly contribute to the determinant primary market spread.

In term of measurement of performance of RCE Marketing, it is significantly consistent profitable throughout the period even each share that shareholders earns consistently stable during 5 years period. Shareholders are still holding the portfolio for long term. In addition, for the long term debt shows that the improvement in term reducing of debt over equity within the period. Moreover, the dividend paid is increasing every year especially for 2012; which give investor handsomely huge dividend for every share they hold. It shows that the value of the company keeps on increasing every year. Besides, there is a room for improvement over the basic model of this study; by adding more variables. The model can also be expanded by adding new macro factor variables such as GDP, inflation rate, budget as well as other default and recovery risk characteristic such as credit rating, credit enhancement and others to make the model more acceptable and make the study more robust. Besides, future researchers can relate the pricing theories with the determinants to make the future study more interesting. Findings from this study can contribute to the existing literature on primary market spread particularly on advanced emerging markets for future researchers.

ACKNOWLEDGEMENT: *This research and confrence in Prague, Republic Chec was supported and funding by Research Acculturation Grant Scheme (RAGS) [File No : RAGS/1/2015/SS01/FPTT/02] Ministry of Higher Education and Universiti Teknikal Malaysia Melaka.*

LITERATURE:

1. Blackwell, D.W. & Drew W. (1997). Banking relationships and the effect of monitoring on loan pricing. *Journal of Financial Research,20,* 275-289
2. Boehmer, E. & W. L. Megginson.(1990).Determinants of secondary market prices for developing country syndicated loans. *Journal of Finance,45,*1517-1540.

3. Booth, J. R. (1992). Contract costs, bank loans and the cross monitoring hypothesis. *Journal of Financial Economics,31*, 25-41
4. Drucker, P. (1993). *Managing in Turbulent Times.*New York: Harper & Row.
5. Edwards, S. (1984). LDC foreign borrowing and default risk: An empirical investigation, 1976-80. *American Economic Review, 74*, 726-734.
6. Eichengreen, B. & Ashoka M. (2000). Lending booms, reserves and the sustainability of short-term debt: inferences from the pricing of syndicated loans. *Journal of Development Economics,63*, 5-44.
7. Fabozzi F.J., & D Vink. (2012). Determinants of Primary Market Spreads on U.K. Residential Mortgage- Backed Securities and the Implications for Investor Reliance on Credit Ratings. *Journal Of Fixed Income, 21*(3), 7–14
8. Fabozzi, F. J., & Vink, D. (2012). Looking Beyond Credit Ratings: Factors Investors Consider In Pricing European Asset-Backed Securities. *European Financial Management, 18*(4), 515– 542
9. Fong, L.F. (2013). Malaysia leading in Global Sukuk. The Star, p. A4. Retrieved from http://www.thestar.com.my
10. Merton, R C (1974). On the pricing of corporate debt: the risk structure of interest rates. *Journal of Finance , 29*(2), 449-70
11. Rating agency Malaysia (2012). Credit Rating Rationale for Cagamas MBS Berhad. April, Kuala Lumpur
12. Seagraves, P. A. (2012). A Multi Factor Probit Analysis of Non-Performing Commercial Mortgage Backed Security Loans. Georgia State University.
13. Smith, C. W., Jr (1980). On the theory of financial contracting - the personal loan market. *Journal of Monetary Economics,6*, 333-357
14. Sorge, M. & B. Gadanecz (2004). The term structure of credit spreads in project finance, *Working Papers, Bank for International Settlements* .
15. Vink, D., & Thibeault, A. E. (2007). An empirical analysis of asset-backed securitization. *NRG Working Paper Series.* Nyenrode Business Universiteit
16. Vink, D. (2008). An Empirical Analysis of Asset-Backed Securitization, 21st Australasian Finance & Banking Conference 2008 Paper.
17. White, H., (1980), A heteroscedasiticity-consistent covariance matrix estimator and a direct test for heteroscedasticity, *Econometrica ,48*, 817-838.

THE GOING-CONCERN ASSUMPTION IN THE ASSESSMENT OF MANAGEMENT AND AUDITORS

Iwona Kumor
University of Economics in Katowice, Poland
iwona.kumor@ue.katowice.pl

Lucyna Poniatowska
University of Economics in Katowice, Poland
lucyna.poniatowska@ue.katowice.pl

ABSTRACT

A going concern is one of the fundamental assumptions, principles and concepts adopted in accounting and stipulated in national and international regulations. This principle is of significance when financial statements are prepared and audited as well as when they are interpreted by a variety of stakeholders. National and International Accounting and Auditing Standards impose on an entity's management and auditors an obligation to make an assessment of its ability to continue as a going concern. The fulfillment of this obligation by the persons burdened with it is both essential and complex. The paper describes the essence of assumptions of the going concern and characterizes the symptoms of the threat to the continuation of activity. It recognizes the need for the analysis and assessment of an entity's ability to continue as a going concern by its management and auditor. The aim of the paper is to identify and classify the symptoms and indications concerning the threats to the assumption of activity continuation based on national and international regulations as well as to conduct their critical analysis. Additionally, the purpose of this article is to indicate the financial auditing procedures that allow for the verification of management's positive assessment of an entity's ability to continue as a going concern are identified. The paper proposes the hypothesis that the auditor's unqualified opinion on an entity's ability to continue as a going concern cannot attest to this ability. In order to achieve the primary and secondary goals of the study and verify the research hypothesis, the authors conducted the literature review and the review of legal acts in the area of national and international accounting and auditing regulations. They applied the method of deduction and synthesis.
Keywords: *accounting principles, financial statement, going concern*

1. INTRODUCTION

A financial statement is the primary source of data used to assess an entity's financial and capital position as well as financial performance. It also contains information necessary to verify the assumption of a going concern adopted by the management.

The users of financial statements expect the information included in the financial statements to be fair, relevant and reliable, as it will help them make rational decisions. Undoubtedly, the accounting principles play an important role in satisfying the informational needs of financial statement users in an optimal manner. One of these principles is the going concern principle, which allows accounting specialists to provide information fulfilling the above criteria.

Financial audit, on the other hand, aims to build the trust of the users of information included in the financial statements by providing an auditor's opinion.

In the paper, the authors discuss the essence of the going concern assumption and the indications of the threats to continued activity. They also indicate the need for the analysis and assessment of an entity's ability to continue as a going concern by its management and auditor.

The aim of the paper is to identify and classify the symptoms and indications concerning the threats to the continuation of activity based on national and international regulations as well as to conduct their critical analysis. Additionally, the purpose of this article is to indicate the financial auditing procedures that allow for the verification of management's positive assessment of an entity's ability to continue as a going concern.
The paper proposes the hypothesis that the auditor's unqualified opinion on an entity's ability to continue as a going concern cannot attest to this ability.
In order to achieve the primary and secondary goals of the study and verify the research hypothesis, the authors conducted the literature review and the review of legal acts in the area of national and international accounting and auditing regulations. They applied the method of deduction and synthesis.

2. THE ESSENCE AND MEANING OF THE GOING CONCERN

The essence of the going concern concept is the assumption that an economic entity will conduct economic activity for the period of time sufficient for it to meet existing obligations. Based on this assumption, entities present information concerning resources, obligations and operational activity and they use it to forecast their future operational activity (Hendriksen van Breda, 2002 pp. 165-166; Elliott, Elliott, 2005 pp. 46-47).
The going concern principle is defined both in national and international accounting regulations and in national and international standards on auditing. Pursuant to the Accounting Act [Accounting Act of 1994, Article 5, paragraph 2], management, while applying the accepted accounting principles (policy), assumes that an entity will continue its operations to a no lesser extent in the foreseeable future, without being put into liquidation or becoming bankrupt, unless this is inconsistent with the factual or legal state of affairs. This regulation included in the Act is based on the guidelines presented in the EU Directive [Directive of the European Parliament and Council] that assumes that an entity will continue its operations. The International Accounting Standard 1, in turn, stipulates that when preparing financial statements, management makes the assessment of an entity's ability to continue as a going concern [IAS 1, paragraph 25]. An entity prepares financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so [IAS 1, paragraph 25; IFSR 570, p.99].
Under the Conceptual Framework of the International Financial Reporting Standards (IFRS), the going concern principle constitutes the basic assumption in the preparation of financial statements. The adoption of the going concern assumption involves the application of general rules for the measurement of assets and liabilities stipulated in the balance sheet law. In the situation when the going concern assumption is not justified, the measurement of an entity's assets and liabilities and the preparation of financial statements may have to be conducted according to different rules [The Conceptual Framework, IFRS, paragraph 4.1; Accounting Act, Article 29, item 1]. The Accounting Act sets out these rules in Article 29, specifying that the entity's assets are measured at net realizable selling prices no higher than their acquisition prices or manufacturing costs, less any accumulated depreciation or amortization charges as well as impairment losses recognized so far. Additionally, pursuant to the Act, the entity is also obliged to provide for any additional costs and losses resulting from the discontinuance or loss of ability to continue operations and to recognize these provisions and the adjustments to equity resulting from the revaluation [The Conceptual Framework for Financial Reporting, paragraph 4.1; Accounting Act, Article 29 item 1; Kumor, 2015, p.131].
Pursuant to IAS 1 and the Accounting Act, the obligation to assess the grounds for assuming that an entity is a going concern was imposed on an entity's management. While assessing the entity's ability to continue as a going concern, management takes into account all the available information concerning the future covering the minimum of 12 months from the

balance sheet date. The scope of analysis depends on a factual situation [The Conceptual Framework for Financial Reporting, 2011, p. A44; IAS 1, 2011, p. A 417; Accounting Act 2016, Article 5, paragraph 2; Kumor, 2015, p. 131]. The responsibility to consider the appropriateness of management's use of the going concern assumption was similarly regulated in the International Standard on Auditing 570. The Standard does not indicate the period of assessment, but it requires an auditor to formulate an opinion on the future outcomes of events or conditions as of a particular moment, which involves a degree of uncertainty [ISA 570, 2010, p. 99].

Pursuant to the Polish balance sheet law, the information on adopting the going concern assumption and potential circumstances indicative of a threat to continued activity should be included in the introduction to the financial statements or, in the case of microentities, in general notes. The information on the threats to an entity as a going concern have to be revealed in the notes to the financial statement. The notes should also include the description of actions, undertaken and planned by management, aiming to eliminate uncertainty [Accounting Act, 2016, Annex No. 1 and Annex No. 4]. When an entity discontinues the part of its operations that affects the expenses and income and it intends to continue as a going concern, it is required to disclose separately the income and expenses of the continuing and discontinued operations [Accounting Act, 2016, Article 47 item 3]. In addition, IAS 1 recognizes the necessity to present the assumptions underlying the preparation of the financial statements and the reason why the assumption that an entity has an ability to continue as a going concern has not been deemed reasonable [MSR 1, 2011, p. A417; Głębocka, 2013, p. 548; Kumor, 2016, p. 451].

The ability to continue as a going concern is of significance for a variety of stakeholders, including management, shareholders, suppliers, employees, the state government. Shareholders consider it important as they expect a return on their investment. Management and employees will receive remuneration from an entity continuing as a going concern, while suppliers will benefit from demand for their products and customer satisfaction. The state government will collect taxes on income generated by the continued operations of an entity [Kumor, 2016, p. 450: after Kita, Kołosowska, 2015, p.53].

3. THE SYMPTOMS OF THE THREATS TO THE GOING CONCERN ASSUMPTION

Pursuant to the balance sheet law, an entity's management is obliged to declare whether the financial statements were prepared based on the going concern assumption. The regulations, however, do not require the justification for such an assumption. The assumption adopted by management depends, to a significant extent, on the subjective assessment made by an entity's management, which is recognized in ISA 570, where the adoption of the going concern assumption is made under conditions of material uncertainty and, in this situation, the auditor's responsibility is to verify the disclosed information and its presentation in this respect (ISA 570, paragraphs 18 and 19). Accordingly, an issue arises whether the identification, classification and analysis of the factors affecting the verification of the going concern assumption will contribute to a more objective verification of this assumption [Gos, Hońko, 2013, pp.139-140].

Undoubtedly, in order to assess the grounds for adopting the going concern assumption by an entity's management, it is necessary to identify the analysis areas for financial and non-financial events and conditions, which include:

- the analysis of a budget and budget implementation,
- the analysis of an entity's financial position,

- the cash flow analysis,
- the analysis of the economic content of agreements,
- the evaluation of the products and markets involved in an entity's operations,
- the evaluation of the opportunities that an entity has to attract additional sources of funding (ISA 570, Szczepankiewicz, 2013, pp.123-124).

The threats to an entity continuing as a going concern relating to the areas presented above can be classified by a number of criteria. In terms of accounting and financial audit, the important division involves the following factors:

- financial,
- non-financial, including operating and other threats (ISA 570, 2010, pp.106-107).

The nature of non-financial risks may be:

- internal (endogenous), originating from an entity itself; they may stem from the condition of financial, capital or human resources and how they are used,
- external (exogenous), resulting from the particular economic reality in which an entity operates.

Financial threats should be measured by an entity and an auditor upon arising and presented to external publics in the financial statement and the documentation created by an auditor. Non-financial threats can be expressed in terms of their value and disclosed only in the subsequent reporting periods (Hołda, 2006, pp.24-25). The discussed classification of the threats to an entity as a going concern is shown in chart 1.

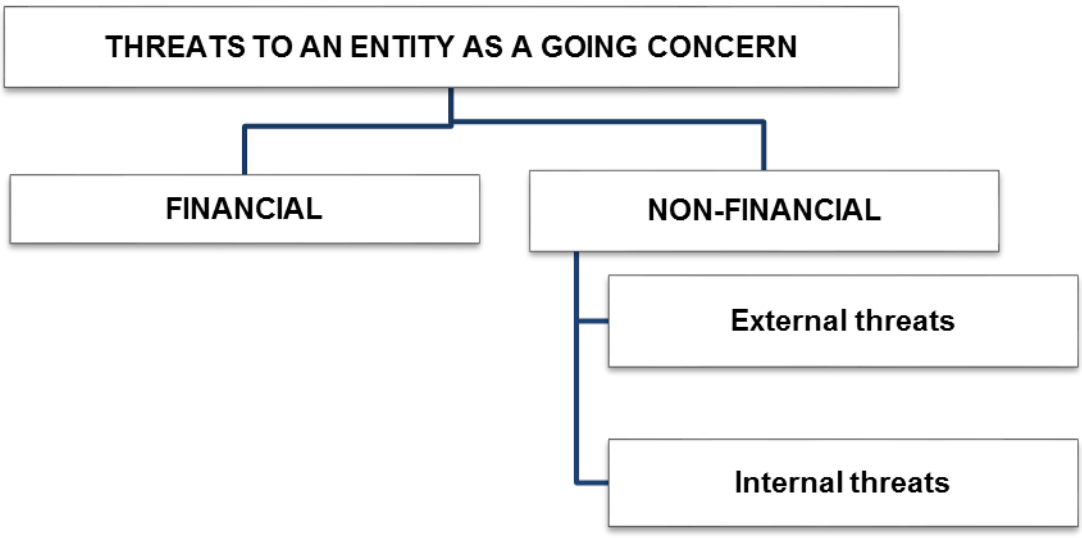


Chart 1: The classification of the threats to an entity as a going concern (Hołda, 2006, p.25)

The national and international accounting standards do not identify any specific symptoms that may point to a threat to an entity as a going concern. The scope of analysis is always related to a factual situation. In profitable entities with access to sources of funding, the scope of analysis may be limited, whereas in other cases management may be forced to consider a number of factors concerning current and expected profitability, loan repayment schemes, and potential sources of alternative funding (MSR 1, 2011, p. A417). The symptoms of threats to an entity as a going concern were indicated in the National Standard on Auditing 1 (NSA 1). NSA 1, item 49, identifies the symptoms of a threat to an entity as a going concern as: significant financial difficulties (lack of liquidity, the termination of credit and loan agreements), negative key financial ratios, the resignation of key management executives, the loss of the core market, licenses, or a major supplier, pending legal or regulatory proceedings against an entity the unfavorable outcome of which will give rise to the obligations that an entity will not be able to fulfill.
The specific symptoms of the threats to an entity as a going concern were classified in the International Standards on Auditing, the guidelines included in ISA 570, taking into account the division of the risks into financial, operating and other. Based on the ISA guidelines, Table 1 shows the examples of the events and conditions that may give rise to doubts relating to an entity's ability to continue as a going concern.

Table 1: The examples of the symptoms of threats to an entity as a going concern

Financial symptoms of threats to an entity as a going concern
1. An entity’s inability to pay its creditors on time 2. Adverse key financial ratios 3. Negative operating cash flows indicated by historical or prospective financial statements 4. Withdrawal of financial support by banks or suppliers 5. Weak financial performance 6. Arrears or discontinuance of dividends 7. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
Non-financial symptoms of threats to an entity as a going concern
Symptom sof external threats 1. Lack of insurance, particularly in industries exposed to a number of different risks, including chance events 2. Changes in legislation or government policy expected to adversely affect the entity 3. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that are unlikely to be satisfied **Symptoms of external threats** 1. Loss of key management and difficulties with replacement 2. Loss of a major supplier 3. Loss of a core market, key customers or licenses 4. Shortage of important supplies and difficulties with their acquisition 5. Labor difficulties 6. Poor governance, absence of development plans

The authors' contention is that the list of events and conditions, both financial and non-financial, reflecting the existence of the threat to an entity as a going concern, can be significantly expanded. An alternative approach is to compile a list of potential risks for a specific entity. Table 2 presents selected examples of events and conditions the evaluation of

which, according to the authors, should constitute the procedural guidelines for financial audit, as they allow for the adoption or rejection of the going concern assumption by management.

Table 2: The symptoms of threats to an entity as a going concern relating to operating activity

Areas of analysis of financial events
1. Analysis of the reliability of the measurement of assets and their impairment loss 2. Analysis of depreciation charges, their presentation and rates 3. Analysis of trade and transactions with related parties 4. Analysis of the tools used to increase an entity's liquidity (conversion of debt to equity, notes, etc.) 5. Analysis of deferred and contingent liabilities, their mechanisms and recognition 6. Analysis of the accuracy of the recognition of revenue, the capitalization of costs and the measurement of profit 7. Analysis of misstated deferred tax liabilities 8. Analysis of potential sources of external funding 9. Analysis of significant exchange rate risk 10.Cash flow analysis in the area of operating activity 11. Analysis of key financial ratios and their tendencies
Areas of analysis of operating events
1. Analysis of the risk of losing key personnel, sudden changes in key positions, and difficulties with recruiting qualified workforce 2. Analysis of the loss of the core markets, a major contractor, or a license 3. Analysis of the acquisition of substantial supplies 4. Analysis of management's plans concerning an entity's future operations 5. Analysis of complying with the terms of the signed contracts
Areas of analysis of other events
1.Analysis of active insurance policies 2. Analysis of sudden changes in ratings 3. Analysis of the effect that changes in legislation or government policy have on an entity's operations 4. Analysis of pending legal or regulatory proceeding against an entity and their assessment in terms of how successfully an entity can satisfy potential claims

The authors propose that the classifications of the symptoms of the threats to an entity as a going concern and their specification presented in Tables 1 and 2, based on the ISA guidelines, may be useful to auditors, internal auditors, and, in particular, to managers and accountants. The confirmation or refutation of the existence of the symptoms representing the threat to an entity would constitute the justification for the adoption of the going concern assumption.

4. FINANCIAL AUDITING PROCEDURES IN THE ASSESSMENT OF THE APPROPRIATENESS OF THE ADOPTION OF THE GOING CONCERN ASSUMPTION BY AN ENTITY'S MANAGEMENT

In the light of the International Standards on Auditing 570, the adoption of the going concern assumption means that an entity is perceived as intending to continue its operations in the foreseeable future. An entity prepares the financial statement based on this assumption, except for the situation when management intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so (ISA 570, p. 99). The responsibility of an auditor in

this respect is to assess, with the use or reliable methods, whether the analysis of an entity's ability to continue as a going concern, conducted by management, is justified.
The responsibility to perform these procedures is stipulated in ISA 570, paragraph, 6, and in NSA 1, item II.12. While assessing management's evaluation of an entity's ability to continue as a going concern, an auditor takes into account whether the period under evaluation is not shorter than 12 months and whether the evaluation accounts for all relevant information that he acquired as a result of the examination (ISA 1, p. 102).
An auditor should ensure the performance of this responsibility by planning and conducting the examination. In the situation when he identifies events and conditions that may give rise to significant doubt whether an entity is able to continue as a going concern, he should obtain relevant evidence that will allow him to confirm this by performing additional procedures taking into account mitigating circumstances. As part of the additional procedures, an auditor should obtain information on management's plans and ways of dealing with all the identified risks and risk areas concerning an entity's ability to continue as a going concern. An auditor's requests to management for information on future actions may, for example, relate to the application for loans and credit, plans to increase capital or intended disposal of assets (Szczepankiewicz, 2013, pp.127-128; ISA 1, p. 102). In the case when material uncertainty affecting an entity's ability to continue as a going concern is recognized, an auditor should consider the extent of disclosure so that the users of the financial statements are not misinformed. Additionally, he has to obtain sufficient and relevant evidence indicating that the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements (ISA 1, 2010, p. 101). Audit documentation concerning the assessment of the appropriateness of management's use of this assumption may, for example, include: the analysis of the financial statements, the analysis of events occurring after the balance sheet date, the analysis of the budget for the next trading year, the statement produced by an entity's manager.
The fulfillment of the criterion of the appropriateness of management's adoption of the going concern assumption has an effect on the opinion on the financial statements issued by an auditor.
If the financial statements disclose information in an adequate manner, the auditor can express an unqualified opinion, but when material uncertainty exists he should include an explanatory paragraph in his report, indicating events or conditions raising significant doubt on the entity's ability to continue as a going concern. If the financial statements do not contain adequate disclosure of information, the auditor should express a qualified or adverse opinion, as it is appropriate under given circumstances (Micherda, 2006, p.9). An adverse opinion should be issued when the financial statements were prepared based on the going concern assumption, but an auditor recognizes, based on his assessment of an entity's ability to continue operation, that there are no grounds to accept that an entity has the ability to continue as a going concern (Pfaff, 2015, p.112).
In accordance with the Accounting Act, in addition to an opinion in writing, an auditor is obliged to prepare a report concerning the audit. The report should focus on an entity's financial position and its financial performance, as well as events that, compared to previous reporting periods, have a significant adverse effect on this position, especially when they pose a threat to an entity's ability to continue as a going concern (Accounting Act, Article 65 paragraph 5, item 7). Also the National Standard on Auditing 1 recognizes the necessity to use financial analysis in the process of auditing the financial statements.
Apart from the analysis of factors constituting the ability to continue operations, the methods most commonly used by auditors to assess the risks to an entity's ability to continue as a going concern are: ratio analysis and discriminate analysis, as well as, less frequently, logit analysis and artificial neural networks. The choice of particular factors and methods should

take into account the core activity of an entity, its legal organization, ownership structure, and environemnt. The study on the application of financial analysis methods and techniques in order to reduce errors in the assessment of the appropriateness of the going concern assumption was conducted by M. Szulc. The results show that, in the process of financial statement audit, the vast majority of auditors (85% of respondents) use ratio analysis to assess an entity's ability to continue as a going concern, approx. 38% use E. Altman's model, while 26% – the Zh model by a. Hołda. The other models and methods (including logit functions and neural networks) were chosen on a sporadic basis. The author also conducted the study on the number of methods used to assess an entity's ability to continue as a going concern. Almost 25% of auditors used one method, more than 28% used two methods, while 14% of the respondents – three methods (Szulc, 2012, p. 240).
According to ISA 1, an auditor is not obliged to perform procedures other than requesting information from management in order to establish whether events and conditions exist that may give rise to doubts whether an entity is able to continue as a going concern over a period of time exceeding 12 months. Accordingly, an auditor has to perform an in-depth assessment of the going concern assumption adopted by management, applying the methods discussed in the paper, performing the review of audit evidence and designing audit procedures.

5. CONCLUSION

Information relating to the going concern assumption adopted by an entity's management remains of crucial importance to the users of financial statements, which is emphasized both in the international and national standards on auditing. Accordingly, an auditor is obliged to perform financial audit procedures, which will allow him to verify the assumption adopted by management. An auditor, however, does not have to perform procedures other than requesting information from management in order to determine whether events and conditions exist that may give rise to doubt whether an entity is able to continue as a going concern over a period of time exceeding 12 months. The users of financial statements do not obtain information relating to the scope of procedures performed by an auditor in order to acquire confirmation of the appropriateness of management's adoption of the going concern assumption. In view of this, the authors argue that the absence of the reference to the uncertainty relating to an entity's ability to continue as a going concern in the auditor's report cannot be perceived as attesting to an entity's capacity for continued activity. This reservation is also included in ISA 570. The rationale behind such an approach is the awareness that an auditor is unable to predict all the events and conditions that may occur in the future, especially in the context of limited procedures performed by an auditor in this respect.
The authors propose that the obligatory scope of financial audit procedures used to determine the appropriateness of management's adoption of the going concern assumption should be expanded or the list of financial audit procedures that would support auditors in this respect should be compiled.

LITERATURE:

1. Adiloglu B., Vuran B. (2011). A Multicriterion Decision Support Methodology For Audit Opinions: The Case Of Audit Reports Of Distressed Firms In Turkey. *International Business & Economics Research Journal, 2011, vol.10, Number 12, pp.37-47.*
2. Elliott, B., Elliott J. (2005). *Financial Accounting and Reporting*. Glasgow: Bell&Bain Ltd.
3. Głębocka M. (2015).Zagrożenie w działalności gospodarczej a rachunkowość – wybrane problemy.Z. Głodek, M. Trocka (ed.) *Wybrane problemy z rachunkowości i*

sprawozdawczości finansowej (p.81). Gorzów Wielkopolski: Studia i Prace Wydziału Ekonomicznego Nr 9

4. Gos W., Hońko S. (2013). Próba kwantyfikacji założenia kontynuacji działalności. *Studia i Prace Kolegium Zarządzania i Finansów. Zeszyt Naukowy 129.*Warszawa: Wydawnictwo SGH w Warszawie
5. Hendriksen E.A., Breda M.F. (2002). *Teoria rachunkowości*. Warszawa: PWN
6. Hołda A. (2006). *Zasada kontynuacji działaności i prognozowania upadłości w polskich realiach gospodarczych.* Kraków: Zeszyty Naukowe AE w Krakowie, Seria specjalna , Monografie 174/286
7. Kumor I. (2016). Identyfikacja i klasyfikacja zjawisk zagrażających kontynuacji działalności i ich ujęcie sprawozdawcze. *Zeszyty Naukowe Uniwersytetu Szczecińskiego, Rachunkowość w zarządzaniu jednostkami gospodarczymi, cz.2, Finanse, Rynki Finansowe, Ubezpieczenia,2/2016 (80)*
8. *Krajowy Standard Rewizji Finansowej Nr 1*
9. Mazurczak-Mąka A. (2013). Weryfikacja wykonalności przyjętego przez jednostkę założenia kontynuacji działalności jako istotny element badania sprawozdania finansowego. B. Micherda, M. Andrzejewski (ed.), *Sprawozdawczość i rewizja finansowa. Problemy kwantyfikacji ryzyka gospodarczego.* Kraków: Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie
10. Micherda B. (2006). Analiza finansowa w badaniu sprawozdania finansowego w świetle Międzynarodowych Standardów Rewizji Finansowej, *Zeszyty Naukowe nr 702,* Kraków: Wydawnictwo Akademii Ekonomicznej w Krakowie
11. *Międzynarodowe Standardy Rewizji Finansowej.* 2010, t.II, Warszawa, KIBR i SKwP
12. *Międzynarodowe Standardy Sprawozdawczości Finansowej*, 2011, IFRS. Warszawa: Stowarzyszenie Księgowych w Polsce
13. Pfaff J. (2015). Rewizja finansowa. Wyd. II , Katowice: Wydawnictwo Uniwersytetu Ekonomicznego w Katowicach
14. Szczepankiewicz, E. I. (2013). Propozycja identyfikacji i klasyfikacji zagrożeń w ocenie zasadności przyjęcia założenia o kontynuacji działalności w jednostkach. *Zeszyty Teoretyczne Rachunkowości, 73 (129).* Warszawa: Stowarzyszenie Księgowych w Polsce
15. Szulc M. (2013). Wykorzystanie analizy finansowej w badaniu sprawozdań finansowych w świetle badań empirycznych. W: B. Micherda (red.), *Kierunki ewolucji sprawozdawczości i rewizji finansowej*. Warszawa: Difin
16. Ustawa z dnia 29 września 1994 r. o rachunkowości. Dz.U. 2016, poz.1047, z poźn. zm.

CLUSTERS AS INSTRUMENTS OF IMPLEMENTATION OF INNOVATION ON THE EXAMPLE OF THE TOURIST STRUCTURES OF EASTERN POLAND

Malgorzata Borkowska-Niszczota
Bialystok University of Technology, Poland
m.borkowska@pb.edu.pl

ABSTRACT

The article presents the role of clusters in the development of innovation. Based especially on research using the desk research method, the most active tourist clusters operating in the macroregion of Eastern Poland were identified along with the innovations which were created on the basis of this cooperation. The research have confirmed the thesis of this paper. Among the innovations, the dominating ones are the product innovations which are linear or network in character, although there are some tourist products such as items or events. A process of interfusion can be observed of different categories of innovation. The conducted literature review allowed to present the research conducted in Poland on innovation in tourism and the dependencies between cooperation in clusters and the innovative character of tourist services.

Keywords: *innovation, clusters, Eastern Poland, tourism*

1. INTRODUCTION

Tourism is currently one of the key sectors of the economy, increasingly interested in implementing innovation. Nowadays, with ever-increasing competition in tourist markets, innovation in products and services is becoming more and more important. Current practice shows that the cooperation of enterprises within the clusters from different branches creates conditions for the development of innovativeness. Also in tourism, for the development of the tourist offer, (especially of innovative nature) it is necessary to involve enterprises from various industries, which are referred to as the tourism sector. They include characteristic types of tourist activity or tourist industries, for whom visitors are a basic group of clients, or whose offer is indispensable for the development of tourism (Dziedzic et al., 2016, p. 6). Therefore, in recent years, we have seen the development of cluster cooperation also in the field of tourism. This is the case, among others, in the area of Eastern Poland, less developed, with an underdeveloped industry strongly dependent on tourism.

Participation in cluster structures, alongside entities providing tourist and pertourist services, government officials, research institutions and non-governmental organizations can foster the implementation of innovation in these entities and lead to the creation of joint innovations, especially innovative and attractive tourism products.

The article is of theoretical-empirical nature. The purpose of this paper is to:

1) presenting, the subject of the problem of innovation, the current Polish research on innovation in tourism services and the role of clusters in the development of innovativeness in tourism, on the basis of literature analysis

2) identification, analysis and description of the types of innovation developed within the framework of co-operation in the most active clusters operating in the tourism industry in the macro-region of Eastern Poland, using the desk research method and the descriptive method.

The thesis of this paper is that the cluster structures of the macro-region of Eastern Poland, operating in tourism, favour the implementation of innovative solutions in tourist services. In particular, they lead to the creation of product innovations.

2 REVIEW OF LITERATURE

2.1. The core of innovation and its usage in tourist services in Poland in light of past research

In literature of management sciences the term 'innovation' is defined in various ways. The most common definition is that created by Eurostat and OECD, where innovation is used to describe 'the introduction of a new or significantly improved product (crafted article or service) or process, a new organisational method or marketing method in economic practice, organization of place of work or relations with the surroundings' (…) while at the same time these products have to be new at least from the point of view of the company which is introducing them (OECD 2005; Szymańska, 2015, p. 23). J.Schumpeter, who is the precursor of the theory of innovation, connected them to the world first introduction of a solution in economic practice. In later periods many authors when defining innovation relate to the introduction of changes in various areas of a company's operations, which allow for a more effective usage of the resources at the company's disposal, better satisfying of consumer needs, achieving better results and gaining advantage over the competition (Czubała, 2015, p. 36). This means that in the beginning innovation was understood as something new, different from past solutions. Currently its seen rather as a change for the better (Osiadacz, 2012, p. 35).

The most often used classification of innovation lists four types: product innovation, process innovation (new technologies and changes in the production process), marketing innovation and organisational innovation. Product innovations are related to creating new service offers or changes in current offers, process innovations related to technological innovations and exist in the area of methods of service provision, marketing innovations are in the product and service sales area as well as are linked to the tools and methods of their sale (new media and promotion techniques, new methods of offer distribution, sales channels, methods of shaping service prices), whereas organisational innovations are created in the area of internal organisation of companies (changes in management methods, organisation structure, active strategy) (Panfiluk et al. 2016, pp. 54-56; Dziedzic et al. 2016, p. 15). Innovations can also be divided into those introduced on a world scale, national scale, regional scale and those which are only new within a company (Szymańska, 2013, p. 134). Innovations with the largest scope (unique on a world scale) are described as radical (absolute innovations), in opposition to all others which can be called incremental (Damanpour, 1991, pp. 555–590). The latter represent marginal changes in knowledge and undertaken actions (Camisón, Monfort-Mir, 2012, pp. 776–789). Innovations adapted from other companies or subjects are called imitative innovations (Osiadacz, 2012, p. 35).

The process of generating innovations enables the companies to stimulate new needs in their recipients, expand the product offer, improve quality, expand the markets, limit internal and external costs, better adjust the company to its surroundings, increase flexibility and improve the efficiency of work (Tomala, Senechal, 2004). Innovation in the service area has a different scope than in the product area – the innovations are usually related to the process of service provision. This does not mean, however, that technology is not important here – the process of providing and selling many of the services is more often based on new technologies. This concerns also tourist companies (Peszko, Kusa, 2006, p. 282). In relations to the tourist sector (apart from the division of innovations presented earlier) the literature presents us with a classification of innovations into: product (e.g. new tourist offers), process of information management (e.g. electronic reservation systems), work organisation

(managerial), marketing and management (e.g. the introduction of integrated systems of tourist information), institutional and in the area of the process of delivering value (Hjalager, 2010, pp. 1–12, Panfiluk et al. 2016, pp. 54-56). Innovations in tourism can occur in one category or a combination of various categories. Innovation activity can be related to subjects of various tourist businesses providing tourist services (related to accommodation, food, transport, organising events, culture, sport, recreational) and offering characteristic tourist products.

Public statistic conducts studies related to the subject of broadly understood innovation. A special category is that of studying innovation activities, conducted based on standard international methodology presented in the Oslo Manual, created under OECD and Eurostat. The studies conducted in Poland by the Central Statistical Office on the innovation activities of companies of the service sector are unfortunately related only to certain sections of NACE. Of the service companies related to the tourist sector the studies included companies connected to land, water and air transport. These studies show that companies who were innovatively active in years 2012-2014 were to the amount of 19% in air transport, 16.7% in water transport, and only 6% in land transport (Dzida et al., 2015). The studies did not include such sections as: activities connected with culture, recreation and sport (90-93), businesses connected to accommodation and food services (55-56), tourism organising and travel agents (79). Studies on the innovations of companies in the tourist sector is very rarely the topic of academic debate (Dziedzic et al. 2016). In literature there are results of surveys on innovation in the hotel industry. The example of lower Silesia in Poland shows that the basic area of innovative activity of the hotel industry in this area was connected to the expanding of the services on offer and the technologies in use (Jędrasiak, 2013, p. 147). Less than 50% of hotels in Wrocław introduces innovations (Puciato, 2013, p. 233). The results of studies on innovation in tourism show that they are most often incremental in character (Peters, Pikkemaat, 2005, pp.1-6, Panfiluk et al., 2016). Nevertheless there are some radical innovations being introduced. This has been confirmed by studies on innovations in Polish companies providing health tourism services. The studies show that 12.07% of companies introduce innovations of a worldwide scope. Most companies introduce product innovations (79%), then marketing (54%), process and management (36.6%) and social (18.84%) (Panfiluk et al., 2016, p. 59, 67). The studies conducted by E.Szymańska (2013) allowed to show examples of organisational, marketing, technological and product innovations of tourism organisers (travel agencies) operating on the Polish market.

2.2 The role of cluster cooperation in innovation development

The attributes of modern innovation are knowledge, partnerships and network connections in generating, adaptation and introduction of new solutions. This was pointed out by Rothwell, who listed five models of innovation: 1) technology push, 2) market pull, 3) technology push combined with market pull, 4) parallel model integrating external and internal engagement in order to increase innovation effectiveness, 5) system integration and networking model based on creating networks, system integrations, efficient communication, which aims to structure the efforts of businesses while maintaining the capability and adaptation abilities which enable the usage of reserves (O'Sullivan, Dooley, 2009, pp. 47-51, Czubała, 2015, p. 36).

Modern innovation models stress the importance of interaction and cooperation between various types of entities as a determinant which speeds up the process of creation and transfer of innovations. The increase of innovation of businesses is caused by cooperation, which significantly influences the competitive position of businesses. Cooperation with other entities is an important element of business operations. It enables a wider access to knowledge and new technologies. It allows to lower costs and risk of businesses and fosters the exchange of experiences and knowledge. Cooperation in the area of innovation means an

active participation in group projects with other businesses and non-commercial institutions. Such cooperation can be long-term and oriented on far-reaching goals and does not have to entail direct, measurable economic benefits for the participating sides (Dzida et al. 2015, p. 97). The functioning of clusters creates especially beneficial conditions for cooperation. Past practice shows that cluster mechanisms favour the introduction of innovations in businesses – the participants of the clusters, as well as those, who remain outside of the cluster. This is due to the fact that cluster cooperation allows for a more effective exchange of knowledge between the members of a cluster i.e. businesses, science units and other entities, which are a part of the value chain. A kind of synergy is formed, which allows for better utilisation of not only the cluster's resources, but also the local ones (Soliński, 2010, p. 36). The most important source of innovation is not knowledge in itself, but rather the connections between different entities which have at their disposal certain types of knowledge, while the most important element of the innovation process is considered to be the interactive learning (Stanienda, 2014, p. 194). Clusters seem to be the proper form of cooperation in tourism. Due to the dynamic development of tourism, an increasing demand for tourist services and products, increasingly varying expectations and needs of tourists, there is the need to expand the scope of the current tourist offers. This requires the organisers of tourism to specialise but also to be versatile, which is a very difficult task. From here arises the need to cooperate with other, very often competitive, entities. Tourism clusters are seen as geographical groupings of interconnected businesses, suppliers, service providers and companies operating in the tourist sector and related institutions (e.g. universities or trade associations and financing institutions), which at the same time compete and, in some aspects, cooperate with each other (Skowronek, 2015, pp. 130-131). The form of a cluster makes it easier to create integrated and territorial tourist products, including service packages, which complement each other, and very often competitive, which not only creates a choice for a potential consumer, but also raises the overall quality (Soliński, 2012, p. 36). A service package which is included in a tourist product, favours cooperation, which is the domain of the cluster. The innovativeness of tourist products is as important as cooperation and it is the cooperation within clusters which creates the perfect conditions for its development (Soliński, 2010, s. 110). Due to this, a common goal of businesses which are members of a cluster is customer satisfaction – the tourist, through offering innovative services which are able to satisfy all requirements (Soliński, 2012, p. 36). Additionally, the presence of rivals in a cluster forces the businesses to creatively distinguish themselves, which in turn maintains the constant innovation activities (Szymoniuk 2003, pp. 232-233). In creating innovative tourist products, the main asset is knowledge absorbed during the cluster cooperation and acquired not only from the participants of the cluster but also from outside of the cluster. Cooperation with science units is especially beneficial to such knowledge exchange. An inspiration and source of information for innovations are: systematic observation of the markets, national and international market research, constant presence at trade fairs, conferences and exhibitions. Internet is also beneficial in expanding the knowledge at the disposal of businesses, as it can be used to observe the competition and to research market trends. A valuable source of information on market trends and the experiences of other businesses and especially an opportunity to develop proinnovative skills and attitudes are trainings and courses for employees, especially at management level (Peszko, Kusa, 2006, p. 282). Research on innovative activities of service sector businesses conducted in Poland by the Central Statistical Office show that in years 2012-2014 24.6% of innovatively active service businesses cooperated in innovative activities. Cooperation with other businesses or institutions related to innovation was conducted by 25% of businesses in air transport, 14.3% in water transport, 7.5% in land transport. In comparison with the years 2011-2013 there was a decrease in service sector entities cooperating in clusters from 16.1% to 13.4%. In years

2012-2014 100% of service sector businesses in water transport and 21.4% in land transport which cooperated in relations to innovation, cooperated within cluster initiatives (Dzida et al. 2015, pp. 100-108). Cooperation benefits innovation in Polish hotels. This is confirmed by studies conducted in hotels in Wrocław. Among businesses providing hotel services, the most innovative are the ones which are integrated with others in systems, chains and hotel networks, or with other entities of the tourist economy or entities of other trades (Puciato 2013, pp. 232-233). Being in a network is also one of the factors stimulating innovative processes of tourism organisers. In the case of businesses introducing radical (unique) innovations, one can distinguish open businesses, which are constantly cooperating with other entities, including units of local government, companies from the tourist sector and other sectors and non-government organisations, very often being members of such organisations themselves (Szymańska, 2013, p. 233).

3 RESEARCH METHODOLOGY

In order to identify innovations as results of cluster cooperation in tourism in the macroregion of Eastern Poland, especially the cluster products created as a result of this cooperation which are innovative, the desk research method was used. Research in this area was conducted in 2016. The main source of information when identifying the common effects of cluster activities were the clusters' web pages. Research was conducted in two stages. The first stage was the identification of cluster structures operating in the five regions of Eastern Poland (podlaskie, warmińsko-mazurskie, podkarpackie, świętokrzyskie, lubelskie). Finally, based on the catalogue of clusters for each region created by the Polish Agency for Enterprise Development, the Map of clusters in Poland – a data base on national clusters, maintained by the Agency, 16 tourist clusters were identified. In the later stage of research 10 the most active clusters were identified, which had active web pages in 2016 (table 1) which presented information on the effects of the cooperative activities of the clusters' members.

Table 1: List of analysed webpages

Webpage's title	URL
Klaster LOT "Kraina Lessowych Wąwozów" (The Local Tourist Organization Cluster 'The Land of Loess Gorges')	http://www.kraina.org.pl
Klaster Marek Turystycznych Polski Wschodniej (Tourism Brands Cluster of Eastern Poland)	http://www.klasterturystyczny.pl
Elbląski Klaster Turystyczny (The Elbląg Tourism Cluster)	http://www.klaster-elblaskaturystyka.pl
The 'Tastes of Carpathia' Cluster (Klaster Podkarpackie Smaki)	http://www.podkarpackiesmaki.pl
LOT Ziemia Mrągowska. Mazurski Klaster Turystyczny (Local Tourist Organization 'The Land of Mrągowo'. The Mazury Tourist Cluster)	http://www.klaster.mazury.pl
Klaster Turystyczny Mazury Zachodnie (West Mazury Tourism Cluster)	http://www.mazury-zachodnie.pl
Klaster "Suwalszczyzna-Mazury" (The 'Suwalszczyzna-Mazury' Cluster)	http://www.krainajacwingow.pl http://www.sot.suwalszczyzna.eu
"Szlak Dziedzictwa Kulturowego" Klaster Społeczny (The 'Trail of Cultural Heritage' Social Cluster)	http://www.lgdbmk.pl
Klaster Jakości Życia „Kraina Podkarpacie" (The Quality of Life Cluster 'The Land of Podkarpacie')	http://www.kraina-podkarpacie.pl
Klaster Restauratorów i Hotelarzy (Restaurant and Hotel Cluster)	http://www.krih.pl

Source: own elaboration.

4 INNOVATIONS AS AN EFFECT OF NETWORK COOPERATION WITHIN TOURISM CLUSTERS OF EASTERN POLAND – RESULTS OF RESEARCH

Of the 16 identified tourist clusters, which were created in years 2006-2013 in Eastern Poland 10 engaged in active cooperation in 2016. A proof of this activity is the cluster's web page and the specific effects of cluster activity presented therein.

The types of innovation (along with their descriptions), including innovative tourist products created within the most active of the clusters are presented in table 2.

Table 2: Innovations created with cluster cooperation in tourism in Eastern Poland
(Ends on the next page)

Types of innovations of individual cluster structures and their descriptions
The Local Tourist Organization Cluster 'The Land of Loess Gorges'
Nordic Walking Park Network – product innovation (trail) – 15 local trails around the Landscape Park (3 types of trails with varied length and difficulty in 5 burrows) with road marks showing the trail's direction, length, remaining time, resting spots, warm-up spots, exercises to be performer before setting out to continue the walk, pulse measurement; maps were designed for individual parks, total length 160km
Nałęczów Literature Trail - product and technological innovation (trail) – including 30 locations – places connected to literary traditions of Nałęczów; the tourists can use a map with all the points of the trail described; an application was also designed with information in mp3 files on the 30 locations on the trail; using an mp4 player available at the Tourist Information Points tourists have the possibility to listen to a few pre-recorded information; the mp3 files can be downloaded from the web page www.kraina.org.pl
Horse-riding trails – product innovation (trail) - 308 km of horse-riding trails in 9 burrows, grouped around 4 main tracks connecting the individual burrows; there are 18 stops on the trail equipped with information boards; the stops provide conditions for camping with horses, water and food for the animals; cooperation between farms offering horse-riding ensures appropriate conditions on the trail
Walking trails in the gorges – product innovation (trail) – gorges in 4 burrows were adapter for tourists – they were equipped with information boards, steps, wooden barriers, wooden benches and the walking trails were marked
Tourism Brands Cluster of Eastern Poland
Themed accommodation packages – product innovation (network product) – for the weekend, for schools, for the family, on historic paths, for business, health tourism, recreational tourism, business tourism, adventure tourism
The Elbląg Tourism Cluster
Horse-riding Trail (large and small loop) –- product innovation (trail) – a trail connecting facilities which can accommodate tourists with horses; trails include riding over hills with inclines and descents, similar to mountains, with long fast straights across beaches of the Vistula Lagoon;
The 'Tastes of Carpathia' Cluster
The Tastes of Carpathia Culinary Trail - product innovation (trail) – the largest culinary trail in Poland; a partnership of 50 culinary facilities (restaurants, vineyards, confectionaries and agritourism farms); each facility offers at least three regional or traditional dishes in their menu and is subjected to a certification process; seven of the facilities have a special shelf labelled Flavours of Carpathia which hosts regional, ecological products from local manufacturers
Local Tourist Organization 'The Land of Mrągowo'. The Mazury Tourist Cluster
The Mazury Tourist Card – product innovation (item) and marketing innovation – a named, tourist discount card, enabling tourists to obtain discounts while sightseeing, using tourist attractions, accommodation services and food services in Mazury; the card comes with a brochure listing all the facilities on offer, containing a map of the region, contacts and useful information on individual facilities
Convention Bureau Mazury - institutional and marketing innovation – the facility is tasked

with promoting of Mrągowo and the region as a conference destination and helping in the organisation of planned business events; the main tasks of the CBM are the presentation of the potential of the region for business tourism on the web page www. KonferencjeMazury.com as well as the publishing of a catalogue of business tourism facilities
West Mazury Tourism Cluster
Themed accommodation packages – product innovation (network products) - 25 packages targeting specific client profiles; packages connected to wellness tourism, history and culture, active tourism, agritourism and education
Internet Map of West Mazury Trails – technological innovation - an interactive map and guide through footpaths, cycling paths and waterways
'The Suwalszczyzna-Mazury' Cluster
Network tourism product Suwalszczyzna-Mazury – product innovation (network product) – a listing of ideas for interesting excursions with the 'Passport Rover' in the historic Land of the Yotvingians; with the prospects: 'Places worth seeing', 'Culinary stops', 'Crafts and traditions', 'Wild Mazury' it is possible to create an individual plan for interesting journeys through the most curious locations and take part in solving puzzles; the passport has six different categories for which stamps can be collected by visiting places recommended in the folders or by solving puzzles in order to receive a prize;
'The Land of the Yotvingians' Internet game – technological and marketing innovation – after returning home there is a possibility of reliving the family adventure in the Land of the Yotvingians by discovering the secrets in this Internet game;
Tourist planner – a catalogue of tourism products of Suwalszczyzna and Mazury Garbate – technological and marketing innovation – enables the promotion and sale of individual tourism products and packages of network products of the 'Suwalszczyzna-Mazury' cluster; creates the possibility to plan the stay in order to discover the wonders of the region
A network of trails with an audio guide - product innovation (trail) and technological innovation – the tourist receives not only the map of the trail running through the most attractive locations, but also the help of a guide, which apart from information on how to get from one location to the next, relates stories about each location which cannot be found in traditional guide books;
Web store with regional souvenirs – marketing and technological innovation – enables the distribution of regional products over the Internet; the shop's offer includes: souvenirs branded 'Made in Suwalszczyzna-Mazury' including objects crafted by sculptors/craftsmen with sacral, nature and fairy tale motifs, embroidered and knitted products, coins, medals, tokens, products for children (key-chains, mascots, magnets) and books on the region
The 'Trail of Cultural Heritage' Social Cluster
Themed accommodation packages – product innovation (network product) – themed offer: the village and nature: the feeling of Mazury; wellness: wellbeing in Mazury
The Quality of Life Cluster 'The Land of Podkarpacie'
IT tool – the SYNERGOS web portal – technological and social innovation – a web portal enabling a social co-design through innovative methods of communication, distribution of information and cooperation of inhabitants, entrepreneurs, local authorities, non-government organisations and others, as well as the creation of products, services and organisational solutions for quality of life sectors i.e. balanced tourism
Restaurant and Hotel Cluster
Workshops on cooking regional dishes – product innovation (event) – spreading the knowledge about the cuisine of the lubelskie region through organising culinary workshops during culinary events in the open air

Source: own elaboration based on the following web pages: www.krainajacwingow.pl (accessed on 15.12.2016); www.sot.suwalszczyzna.eu (accessed n 20.12.2016); www.mazury-zachodnie.pl (accessed on 15.12.2016); www.klaster.mazury.pl (accessed on 20.12.2016); www.podkarpackiesmaki.p (accessed on 21.12.2016); www.kraina.org.pl (accessed on 21.12.2016); www.krih.pl (accessed on 15.12.2016); www.kraina-podkarpacie.pl (accessed on 12.12.2016); www.klasterturystyczny.pl (accessed on 10.12.2016); www.lgdbmk.pl (accessed on 20.12.2016); www.klaster-elblaskaturystyka.pl (accessed on 19.12.2016.

The results of the research show that the tourism clusters operating in Eastern Poland undertake actions aiming to make their product offer more attractive. Most of the identified innovations created as a result of cluster cooperation are product innovations. Among them, there are three products of linear character (trails, themed trails and walking paths), network products in a ready-to-sell format, packaged and commercialised offers, based on the dispersed structure of the products, attractions, locations of service points and facilities, functioning as a cohesive concept with one common denominator (including themed accommodation packages), item products (the Mazury Tourist Card), event products (culinary workshops on regional dishes). In the service sector we often see cross-transfer of individual categories of innovations. The same can be seen in innovations which are the result of cluster cooperation in tourism. Some of the introduced innovations are a combination of product innovations and technological innovations using new IT-communication technologies (trail network with an audio guide, literary trail using pre-recorded information), product or technological innovations and marketing innovations regarding new distribution channels for tourism products, new means of promotion and product information (discount card, shop with regional products, tourism planner, internet game). Among the effects of cluster cooperation one can identify also innovations which are a combination of social, which are understood as the development and introduction of new ideas in order to satisfy social neds and create new social relations and cooperation, and technological (a web portal enabling social Co-design). Special attention needs to be paid to the creation of the Convention Bureau Mazury (institutional and marketing innovation) which helps with organising business meetings in Mazury. This is a specialised facility which intends to integrate the business trade, which aims to promote the region as an attractive location for various types of events.

The effect of cooperation of tourism clusters in Eastern Poland are specialised products aimed at specific market segments (e.g. active tourism products – Nordic walking trails, literary tourism products, horse-riding and culinary tourism). Also accommodation packages as a cohesive themed offer are addressed to specific groups of customers: students, businessmen, families, people interested in wellness tourism, adventure tourism, recreation, history and culture or agritourism. The introduction of the above mentioned innovations is surely aided by other actions of clusters described on their web pages, connected to organising trainings and workshops for cluster members, their participation in fairs and exhibitions, organising conferences, seminars and study trips.

Of all the clusters introducing innovative solutions, the Suwalszczyzna and Mazury Garbate cluster merits special attention, due to actions focusing on creating attractive tourism products including network products making this area stand out in a competitive market, as well as promoting the area and its products using tools of communication with the tourism market created based on modern technologies and techniques of market communication (innovative tourism planner, internet distribution of products using a web store). The cooperation also allowed to create the Centre of Tradition, Inspiration and Creation whose aim is to create group product initiatives of the cluster with creative sectors.

5. CONCLUSION

Past research into tourism innovations were very rare in Poland. They concerned only selected service providers connected to tourism such as transport, hotel, tourism organising, wellness tourism. Additionally, the introduced innovative solutions in tourism services are not common and are usually incremental in character, although there are some which are radical. Research show that network connections stimulate innovative processes.

Among entities providing tourism services in Eastern Poland, there can be seen a need to connect into clusters and build on the basis of this cooperation new values, which will benefit

all of the connected entities. Of all the tourism clusters initiated in the macroregion there are some most active which stand out. A proof of their activities are innovative tourism products (often connected to technological or marketing innovations) directed at increasing the tourism attractiveness of the regions where the clusters operate and fulfilling the needs of various market segments. Cluster activities concentrate around creating local and regional tourism products connected to culture tourism, historic tourism, culinary tourism, wellness tourism, business tourism etc. Clusters play a key role in the development of integrated (network) tourism products which are composed of offers of various service providers. By supporting the creation of innovative tourism products, they can be highly significant for the development of tourism in the macroregion of Eastern Poland.

ACKNOWLEDGEMENT: *The studies have been carried out within the framework of the work No. S/WZ/5/2015, and financed from the resources of the Ministry of Science and Higher Education, allocated to science.*

LITERATURE:

1. Camisón, C., Monfort-Mir, V.M. (2012). Measuring Innovation in Tourism from the Schumpeterian and the Dynamic-capabilities Perspectives. *Tourism Management*, 33(4), 776-789.
2. Czubała, A. (2015). Innowacje w sektorze usług w Polsce. *Zeszyty Naukowe Małopolskiej Wyższej Szkoły Ekonomicznej w Tarnowie*, 26(1), 35-46.
3. Damanpour, F. (1991). Organizational Innovation: A Meta Analysis of Effects of Determinants and Moderators. *Academy of Management Journal*, 34(3), 555-590.
4. Dzida, L., Gumiński, M., Orzechowska, U., Piotrowska, J., Rozkrut, D., Wegner, M. (2015). *Informacje i Opracowania Statystyczne: Działalność innowacyjna przedsiębiorstw w latach 2012-2014*, Warszawa: GUS.
5. Dziedzic, E., Szymańska, E., Zawistowska, H., Heliński, W., Migdal, M. (2016). *Poradnik innowacyjności w turystyce dla przygotowujących oraz oceniających projekty innowacyjne i proinnowacyjne z zakresu turystyki* (p. 110). Warszawa: Ministerstwo Sportu i Turystyki. Retrived 27.12.2016 from www.msport.gov.pl/statystyka-turystyka/poradnik-innowacyjności-w-turystyce.
6. Hjalager, A.M. (2010). A review of innovation research in tourism. *Tourism Management*, 31(1), 1-12.
7. Jędrasiak, M. (2013). Innowacyjność w hotelarstwie na przykładzie wybranych hoteli Dolnego Śląska. In A.Rapacz (ed.), *Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu: Gospodarka turystyczna w regionie. Wybrane problemy funkcjonowania regionów, gmin i przedsiębiorstw turystycznych,* 303, (pp. 140-149). Wrocław: Wydawnictwo Uniwersytetu Ekonomicznego.
8. OECD and Eurostat. (2005). *Oslo Manual: The Measurement of Scientific and Technological Activities. Proposed Guidelines for Collecting and Interpreting Technological Innovation Data*, 3rd ed. (p. 163). Paris.
9. Osiadacz, J. (2012). *Innowacje w sektorze usług – przewodnik po systematyce oraz przykłady dobrych praktyk,* (p. 240). Warszawa: PARP.
10. Panfiluk, E., Szymańska, E., Iwaniuk, E. (2016). Techniki zarządzania innowacjami w turystyce zdrowotnej. *Przedsiębiorczość i Zarządzanie,* T. 17, 7(3), 53-68.
11. Peszko, A., Kusa, R. (2006). Klastry jako stymulatory konkurencyjności przedsiębiorstw i regionów turystycznych. In J.Kot (ed.), *W kierunku gospodarki*

opartej na wiedzy: innowacyjność, konkurencyjność, współpraca w regionie (pp. 280-288). Kielce: Akademia Świętokrzyska.

12. Peters, M., Pikkemaat B. (2005). Innovation in Tourism, *Journal of Quality Assurance in Hosp & Tourism*, 6(34), 1-6.
13. Puciato, D. (2013). Uwarunkowania wdrażania innowacji w przedsiębiorstwach hotelowych z Wrocławia. In A.Rapacz (ed.), *Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu: Gospodarka turystyczna w regionie. Wybrane problemy funkcjonowania regionów, gmin i przedsiębiorstw turystycznych,* 303, (pp. 223-234). Wrocław: Wydawnictwo Uniwersytetu Ekonomicznego.
14. Skowronek, E. (2015). Klaster jako forma współpracy w turystyce. *Europa Regionum*, 24, 124-140.
15. Soliński, T. (2012). Znaczenie klastrów w transferze innowacji i rozwoju turystyki. In J. Krupa, T. Soliński (ed.), *Ochrona środowiska w aspekcie zrównoważonego rozwoju społeczno-gospodarczego Pogórza Dynowskiego* (pp. 35-45). Dynów: Związek Gmin Turystycznych Pogórza Dynowskiego.
16. Soliński, T. (2010). Innowacyjne zarządzanie rozwojem turystyki. In J.Krupa (ed.) *Innowacyjność w turystyce*. Rzeszów: Wydawnictwo Procarpathia.
17. Stanienda, J. (2014). Znaczenie klastrów w innowacyjności przedsiębiorstw. *Zeszyty naukowe Małopolskiej Wyższej Szkoły Ekonomicznej w Tarnowie*, 24(1), 189-200.
18. Szymańska, E. (2013). *Procesy innowacyjne przedsiębiorstw świadczących usługi w zakresie organizacji imprez turystycznych* (p. 293). Białystok: Oficyna Wydawnicza Politechniki Białostockiej.
19. Szymańska, E. (2015). Mapowanie jako metoda kreowania innowacji organizacyjnej. *Przedsiębiorstwo & Finanse*, 2, 23-32.
20. Szymoniuk, B. (2003). Innowacyjność jako warunek funkcjonowania klastrów. Porównawcze studium przypadków. In H. Brdulak i T. Gołebiowski (ed.), *Wspólna Europa - innowacyjność w działalności przedsiębiorstw*. Warszawa: Difin.
21. Tomala, F., Senechal, O. (2004). Innovation management: a synthesis of academic and industrid points of view. *Interanational Joural of Project Management*, 22(4), 281-287.

HUMAN CAPITAL MANAGEMENT AS ONE OF THE FUNDAMENTAL ELEMENTS OF THE CSR CONCEPT

Nora Rodek Berkes
University of Pannonia, Hungary
rodek.nora@uni-pen.hu

Zoltan Birkner
University of Pannonia, Hungary
birkner.zoltan@uni-pen.hu

ABSTRACT

We hear more and more about sustainable development, ethical corporate governance, ecological footprint and similar concepts that are inspiring us to behave and operate responsibly, from individuals to large enterprises. In today's globalized world there is often a blurring of geographical boundaries in business, therefore the corporate executives must keep pace with the parent companies and partners' expectations as well as with the needs of the market and society. Responsible managers should think of social efficiency as an evaluation criterion of their own management processes. How much social welfare is created? Are the employees satisfied with the working conditions? Are they motivated well? Are they growing as human beings in their work, or are they exploited so that they present a lost social capital. The objective of this research therefore was to highlight the importance of human capital management as a decisive element of the CSR concept because this approach is not just about environmental protection and philanthropy. The study introduces a new model, the CSR EMAT (CSR Excellence Management and Assessment Tool) which is a guidance and evaluation criteria that can support the corporate executives in responsible decision making and applying the CSR approach to strategic level. The CSR activities of the companies are evaluated in 5 areas: leadership, strategy, employees, society and environment, product and service. The measurements that were carried out in Hungarian companies are presented in this study focusing on the area of employees. The results of the research show the organizational factors that most contributes to responsible human capital management.

Keywords: *Corporate Social Responsibility, CSR EMAT, Human Capital Management, Responsible management*

1. INTRODUCTION

Responsible leadership has emerged as an umbrella concept to rethink the concept of leadership in the context of stakeholder theory (Waldman and Galvin 2008). It acknowledges that corporations operate in an increasingly interconnected and globalised world and have to move towards more relational modes of interaction with all their constituents. In 2009, senior management thinker Gary Hamel brought together a group of thirty-five eminent management specialists called ’the renegades’ who developed twenty-five recommendations for management of the future. Their first three recommendations were all related to ethics, sustainability and responsibility. 1. Management must orient itself to achieve noble, socially significant goals. 2. They must embed the ideas of community and citizenship in management systems. There is a need for processes and practices that reflect the interdependence of all stakeholder groups. 3. Reconstruct management’s philosophical foundations. (Laash, 2015)

The implementation and integration of CSR brings about cultural changes (Maon et al. 2009) that are evidenced by the adoption of different work practices. For instance, these practices can link employee rewards and recognition to the adoption of socially responsible behaviours, establish iterative learning and management, as well as increasing employees’

awareness of stakeholders (Lyon 2004). Although employees are recognized as a crucial stakeholder group on which leaders should focus their attention (Maak 2007), in many cases the opposite is observed. According to previous research in Hungary, the scope of the concept of CSR is not clear among most of the managers and they are not familiar with its contents neither. Most of the company leaders identify CSR with environmental protection, charity and sponsorship. The CSR concept has although much more elements such as the responsibility for employees. We wanted to get a comprehensive picture of their responsible operation, not just about the areas they communicate outward. We believe that if a company is truly committed to CSR, the approach should affect the entire organization. Based on these ideas, we sought the answer to the following research questions:

- Do companies with outstanding CSR intensity pay the same attention toward their employees as well?
- Typically, what types of companies achieve outstanding results in the area of employees?

Human resource is increasingly valued nowadays. Employee satisfaction and motivation are indispensable for effective work. The elements of the CSR concept (listed in Table 2) contribute to the achievement of these goals. It is important, therefore, not only to concentrate on outward CSR activities, but also on the inward ones toward the employees, as this is an important condition not only for a good working atmosphere but also for the competitiveness.

2. CHAPTER - Theoretical background

Human capital is the skill, talent, and productivity that employees bring to a company. It refers to the capital produced by investing in knowledge. Human capital is recognition that people in organisations and businesses are an important and essential asset who contribute to development and growth, in a similar way as physical assets such as machines and money. The collective attitudes, skills and abilities of people contribute to organisational performance and productivity. Any expenditure in training, development, health and support is an investment, not just an expense. (Lakatos, 2005) Davenport (1999) distinguished four elements of human capital, such as ability, behaviour, effort and time. Ability is nothing but expertise in different forms of work. The following parts of ability are known: knowledge, skill and talent. According to Lazear (2006), human capital as "knowledge, experience and skill" is a form of capital, part of the organizational wealth. Its operation and development is expensive and requires major investments from both the individual and the organization's side. The literature on management uses primarily the expression of human resource. Human resources provide the company at least two resources at a time. On one hand the workers' physical ability to work, on the other hand their knowledge and creativity. (Juhász, 2005) The essence of human resource evaluation is the created value of the company by using the working ability (intellectual and physical) and time purchased from the employees in the most effective way. It is worth for businesses to invest in human resources. According to Fritz Machlup (1982) we can talk about human resource investment when the purpose is to transform the mental and physical preparation of people in order to enable them:

- to provide more or better goods/services,
- to obtain higher cash incomes,
- to spend their income more meaningfully.

As an investment, for example, the following options may appear:
• Health care
• Workplace training and retraining

• Adult training outside the workplace
• Research

CSR can (a) reassure concerns about safety and security, (b) provide positive distinctiveness and enhance social identity, (c) symbolize commitment to important values and engender a sense of belongingness, and (d) add meaning and provide a greater sense of purpose at work. (Ingham, 2007) Research often addresses how CSR affects important stakeholder groups, especially investors (Graves & Waddock, 1994) and consumers (Sen & Bhattacharya, 2001), but it has tended to neglect employees (Aguilera et al., 2007; Aguinis & Glavas, 2012). CSR activities (i.e., those advocated by proponents of the expansive but not the narrow view on CSR) represent one way companies can attempt to move beyond decency and approach corporate morality in the eyes of their employees and other stakeholders. CSR increases perceived corporate morality, which in turn can help to satisfy employees' needs for security, self-esteem, belongingness, and a meaningful existence. (Ellemers, 2011)

CSR means the activities of a company that support the society while relating to legal standards and the direct interests of the company. The responsible operation has a number of results that supports sustainability and thereby the long-term competitiveness as well. (Szlávik, 2013) The implementation of the corporate social responsibility concept is affected by the people who make up the organization. The key element of CSR-oriented management is the leadership itself and its commitment, habit, ethical compliance, disposition and socialization experience. The social commitment of the company to the practical aspects of CSR: 1. unifying the CSR orientation of the management 2. the development and operation of reporting and measurement systems 3. the continuous improvement of the quality of work 4. social and eco-labels, the purposeful and conscious use of product marks 5. implementing socially responsible investments. (Kun, 2004)

According to World Business Council for Sustainable Development, the definition of CSR is the following: commitment of business to contribute to sustainable economic development, with the employees, their families, local community and society cooperating in order to improve the quality of life. (EC, 2001) CSR is regarded as a set of tools that improves working conditions beyond legal requirements and it is favorable for the society. (Vogel, 2006) Many companies are focusing on corporate social responsibility issues but unfortunately, most companies are still based on self-interest and make CSR the part of their economic calculation, which is the opposite of altruistic ethical behavior. (Holliday, 2002) The main points of Corporate Social Responsibility (CSR) concepts are; that after mapping who their stakeholders are, the company has to incorporate these CSR values and interests into their business operation while maintaining their profitability. Socially responsible behavior radiates confidence towards both employees and consumers. (Frank, 2004) Many companies, however, see that a few donations and environmental measures are enough for responsible behavior. However, for the sustainable development a long-term strategy is needed.

Table 1 demonstrates the international CSR guidelines and standards and their core subjects. Since the early 1990s, the European Commission has taken an active interest in corporate social responsibility (CSR). In 2001, this interest manifested itself in the form of a green paper (or consultation document) entitled 'Promoting a European framework for corporate social responsibility'. This 35-page document sets out the principles underlying CSR and introduces some of the sustainability tools at the disposal of companies and governments. The UN Global Compact is a call to companies everywhere to: 1. voluntarily align their

operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption and 2. take actions in support of UN goals, including the Millennium Development Goals. The Global Reporting Initiative (GRI) is a leading organization in the sustainability field. GRI promotes the use of sustainability reporting as a way for organizations to become more sustainable and contribute to sustainable development. GRI has pioneered and developed a comprehensive Sustainability Reporting Framework that is widely used around the world. A sustainability report is a report published by a company or organization about the economic, environmental and social impacts caused by its everyday activities. ISO 26000:2010 provides guidance rather than requirements, so it cannot be certified to unlike some other well-known ISO standards. Instead, it helps clarify what social responsibility is, helps businesses and organizations translate principles into effective actions and shares best practices relating to social responsibility globally. It is aimed at all types of organizations regardless of their activity, size or location. The standard was launched in 2010 following five years of negotiations between many different stakeholders across the world. Representatives from government, NGOs, industry, consumer groups and labour organizations around the world were involved in its development.

Table 1: CSR Guidelines and Standards (authors research data, 2016)

European Commission (2001)	*UN Global Compact*	*GRI*	*ISO26000*	*Core subjects of CSR*
Social responsibility integrated management			Organizational governance	1. Leadership
Adaptation to change		Economic		2. Employee
Human rights	Human rights	Human rights	Human rights	3. Environment
Human resource management/ Health and safety at work	Labour	Labor practices and decent work	Labour practices	4. Society
Management of environmental impacts and natural resources/ Global environment concerns	Environment	Environmental	Environment	5. Product and service
	Anti-corruption		Fair operating practices	
Local communities		Society	Community involvement and development	
Business partners, suppliers and consumers			Consumer issues	
Social and eco- labels		Product responsibility		
SRI (Socially responsible investment)				
Quality in work				
Social responsibility reporting and auditing				

The guidelines and standards related to CSR were collected into a table to see what are the core subjects they have in common. As a result, the determined elements of the CSR concept can be found in the last column of the table. 1. Leadership 2. Employee 3. Environment 4. Society 5. Product and services. These five elements served as the basis for the CSR EMAT model.

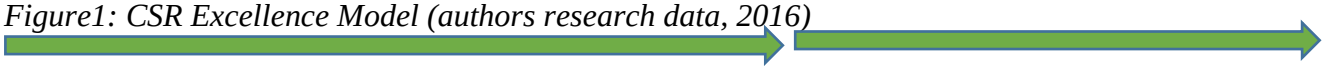
3. CHAPTER - Methodology

To find the answers for our research questions, we used the CSR EMAT (CSR Excellence Management and Assessment Tool) which is a guidance and evaluation criteria. It enables companies to learn about the CSR concept and its elements, so this information could help them in responsible decision making. After collecting the elements of international standards and directives for social responsibility and sustainability, a quality management system was chosen which framework was appropriate to develop the CSR excellence model. The CSR excellence management and assessment tool was developed based on the logic of the EFQM Excellence Model.

The EFQM Excellence Model is based on a set of European values and was introduced in 1992. Today, it is the most widely used business excellence model in Europe, more than 30,000 organizations use it to improve performance. The model is a practical, non-prescriptive framework that enables organisations to assess where they are on the path to excellence and provide a basic structure for the organisation's management system. The EFQM Excellence model contains three integrated components: the fundamental concepts of

excellence, the EFQM excellence model and the RADAR logic. The EFQM Excellence Model is a framework based on nine criteria. Five of these are 'Enablers' and four are 'Results'. The 'Enabler' criteria cover what an organisation does and how it does it. The 'Results' criteria cover what an organisation achieves. 'Results' are caused by 'Enablers' and 'Enablers' are improved using feedback from 'Results'. Each criterion is supported by a number of criterion parts. Criterion parts are statements that describe in further examples what should be considered in the course of an assessment.

Figure1: CSR Excellence Model (authors research data, 2016)



Enablers			***Results***	
1.Responsible leadership	**2.Employee**	**5.Products & Services**	**6.Employee results**	**9.CSR Results**
	3.Strategy		**7.Customer results**	
	4.Society&Environment		**8.Society&Environment results**	

Learning, Creativity and Innovation

The certain areas of the model (in Figure 1) are divided into criterion parts on the basis of the sub-areas of international standards and guidelines. The assessment tool is intended to evaluate the CSR activities of organisations of all sizes and from all sectors in order to be able to compare them. Beyond the assessment, the aim of the CSR EMAT system is to provide a guidance for company managers in the interpretation of the CSR approach and a kind of best practice data base that can help them to learn about the opportunities of applying this concept. The fundamental concepts of the CSR Excellence Management and Assessment Tool (CSR EMAT) are: 1. Responsible and ethical management 2. Strategy for responsible and sustainable operation and development 3. Creating value for the society 4. Taking into account the interests of stakeholders 5. Employee appreciation and motivation 6. Relations with partners and customers 7. Responsible product and service 8. Being responsibility for the environment. The CSR EMAT is a complex management guidance that beside the fundamental concepts and their definitions, also contains the assessment tool that can evaluate the intensity of the CSR activity of a certain company.

94 small, medium sized and large companies were evaluated in Budapest and in rural towns in Hungary. We personally visited the companies, interviewed the CEOs and evaluated their CSR activity based on the criteria system. We wanted to get a comprehensive picture of their responsible operation, not just about the areas they communicate outward. In many cases it turned out that many CSR activities can be found in practice, but they do not do it consciously, but rather from internal intent. On the other hand, there were also companies that are constantly communicating their CSR activities but did not achieve a remarkable overall result in the assessment process. We believe that if a company is truly committed to CSR, it should affect the entire organization not just appear in one or two areas. As most of the companies communicate mainly their environmental and philanthropic activities, we were curious about how companies are taking care of their employees? Do companies with outstanding CSR intensity pay the same attention toward their employees as well? What types of companies achieve outstanding results in the area of employees?

4. CHAPTER - Results

Employees are primary stakeholders who directly contribute to the success of the company, understanding employee reactions to corporate social responsibility may help to answer lingering questions about the potential effects of corporate social responsibility on firms as well as illuminate some of the processes responsible for them.

Table 2: Responsibility for employees in CSR EMAT (authors research data, 2016)

Employee
Non-discrimination and equal opportunity
Life long learning and training programmes
Better balance between work, family and leisure
Equal pay and career prospects for women
Health and safety at work
Ensure proper working conditions
Fringe benefits
Fair wages
Recognition, incentive and motivation system
Informing the employee
Management and employee relations

Table 2 illustrates the areas we have examined in case of the employees. The criterias were collected on the basis of the content of international guidelines and standards. We have examined the extent to which the above-mentioned aspects have been implemented, as well as the ways how the company's management supports their employees.

Table 3: The best employee results (authors research data, 2017)

Company's headquarters	***Year of foundation***	***Company's activity***	***Number of employees***	***Ownership structure***	***Employees***	***Employee results***	***CSR Excellence***
Budapest	1935	service	60.000+	foreign	100%	**89,30%**	84,60%
Budapest	1911	service	2500	foreign	91,67%	**71,43%**	81,38%
Budapest	1986	service	2474	foreign	100%	**100%**	97,70%
Countryside	1975	industrial	380	foreign	100%	**75%**	80,32%
Budapest	2004	service	3500	foreign	79,20%	**85,70%**	90,96%
Countryside	1995	industrial	500	foreign	95,83%	**75%**	73,58%
Countryside	1999	service	64	Hungarian	95,83%	**71,43%**	64,39%
Countryside	1995	service	38	Hungarian	100%	**87,50%**	82,05%
Countryside	1975	service	170-300	Hungarian	95,83%	**82,14%**	72,17%
Budapest	1911	industrial	201	foreign	79,17%	**75%**	60,29%

Table 3 illustrates the best employee results. The percentage results show how much the examined companies have received in that area from 100%. We can see from the results that the companies who have achieved the best results in the area of employees have achieved similarly good results in CSR excellence as well. This is a positive result as it presupposes

that CSR is an integral part of the company's operations and it is not limited only to outbound activities. The outstanding results can be observed especially in case of the medium sized and large companies with foreign ownership structure. This is not surprising because foreign managers bring the CSR approach with them which is currently still in the unfolding phase in Hungary. As for the company's activity, the service providers have the highest CSR intensity.

Table 4: The worst employee results (authors research data, 2017)

Company's headquarters	***Year of foundation***	***Company's activity***	***Number of employees***	***Ownership structure***	***Employees***	***Employee results***	***CSR Excellence***
Countryside	2000	industrial	650	foreign	70,84%	**25%**	44,15%
Countryside	2004	industrial	249	Hungarian	87,50%	**21,43%**	52,66%
Countryside	1990	industrial	150	Hungarian	95,83%	**21,43%**	62,23%
Countryside	1989	industrial	65	Hungarian	87,50%	**25%**	52,66%
Countryside	1998	service	11	Hungarian	66,67%	**10,71%**	47,34%
Budapest	1994	service	3700	foreign	54,16%	**25%**	46,81%
Countryside	1976	industrial	2485	Hungarian	79,16%	**21,42%**	47,34%
Countryside	2003	service	120	Hungarian	21%	**21%**	21,80%
Countryside	1995	service	20	Hungarian	54,16%	**10,71%**	41,49%
Budapest	1948	service	43300	Hungarian	68%	**22%**	38,44%

Table 4 illustrates the worst employee results. We can see from the results that the companies who have achieved the worst results in the area of employees have achieved similarly weak results in CSR excellence as well. This is probably because these companies have mainly Hungarian owners. As it was stated before, the scope of the concept of CSR is not clear among most of the managers in Hungary and they are not familiar with its contents neither. If they operate in a socially responsible way, they do not make it consciously at a strategic level. The weak results can be observed especially in case of the companies located in the countryside, where the new trends and management approaches are spreading slower than in the capital.

5. CONSLUSION

Previous research in Hungary revealed that most of the company managers are not familiar with the concept of CSR. In many cases, they operate in a socially responsible way without knowing anything about CSR. The CSR EMAT can help them to identify the CSR activities of their companies and it also shows improvement opportunities, as the model is based on the logic of TQM (Total Quality Management). With the use of the assessment tool the CSR intensity of different companies (in size, profile and ownership structure) can be comparable and the results can help to designate the areas to be developed. It is important because if a company is truly committed to CSR, the approach should affect the entire organization not just one or two areas. Our intention with this research was to find out how companies are taking care of their employees. Two research questions were formulated: Do companies with outstanding CSR intensity pay the same attention toward their employees as well? What types of companies achieve outstanding results in the area of employees? The results revealed that the companies who have achieved the best results in the area of employees have achieved similarly good results in CSR excellence as well. These are the companies where the CSR approach is integrated at a strategic level. The **outstanding results in CSR excellence** can be

observed especially in case of the **medium sized** and **large companies** with **foreign ownership structure** who are operating in the **service sector**. Leadership therefore has a very important role to play in the application of CSR at management level. HR can enhance the centrality of employees in CSR strategies and co-design processes whereby employees shape CSR practices. This is essential to the development of CSR policies that reflect and fulfil employees' needs. HR can monitor the relationship with employees by evaluating and assessing employees' perceptions of CSR programs and policies and by adjusting accordingly the programs sustaining responsible leadership. The presence of such monitoring processes is important in collecting employees' feedback and thus enhancing corporate learning from prior actions with this crucial stakeholder. Based on these, as a continuation of the research it would be worth examining the detailed responses about the areas where the employees receive the most support (based on Table 2) and the areas where they receive the least support. On the other hand, it could function as a kind of feedback to ask the other side, the employees, to evaluate the same aspects and then to compare those results.

As a summary, one of the most important elements of the CSR concept is the responsibility for the employees. It is important for the management to apply the CSR approach at a strategic level because responsible operations has positive impact on the environment, society and employees as well.

LITERATURE:

1. Aguilera, R., Rupp, D. E., Williams, C. A., & Ganapathi, J. (2007). *Putting the s back in corporate social responsibility: A multilevel theory of social change in organizations*. Academy of Management Review, 32, 836–863.
2. Aguinis, H. (2011). *Organizational responsibility: Doing good and doing well*. In Zedeck, S. (Ed.). APA handbook of industrial and organizational psychology. Vol. 3 (pp.855–879). Washington, DC: American Psychological Association.
3. Aguinis, H., & Glavas, A. (2012). *What we know and don't know about corporate social responsibility: A review and research agenda*. Journal of Management, 38, 932–968.
4. Benn, S.- Bolton, D. (2011). *Key Concepts in Corporate Social Responsibility*. SAGE Publications, London.
5. Drucker, P. (1993). *Managing in Turbulent Times*. New York: Harper & Row.
6. Dutton, J. E., Roberts, L. M., & Bednar, J. (2010). *Pathways for positive identity construction at work: Four types of positive identity and the building of social resources*. Academy of Management Review, 35, 265–293.
7. Ellemers, N., Kingma, L., van de Burgt, J., & Barreto, M. (2011). *Corporate social responsibility as a source of organizational morality, employee commitment and satisfaction.* Journal of Organizational Moral Psychology, 1, 97–124.
8. European Comission (2005). Opinion of the European Economic and Social Committee on Information and measurement instruments for corporate social responsibility (CSR) in a globalised economy.
9. Europoean Comission (2002). Communication from the Commission concerning Corporate Social Responsibility: A business contribution to Sustainable Development.
10. Fekete, L. (2005). *Hungary – Social Welfare Lagging Behind Economic Growth*. In Habish, A. – Jonker, J. – Wegner, M. – Schmidpeter, R. (Eds): Corporate Social Responsibility Across Europe, Springer, Berlin-Heidelberg.
11. Frank, R. H. (2004). *What Price the Moral High Ground? Ethical Dilemmas in Competitive Environments*. Princeton University Press, Princeton.
12. Graves, S. B., & Waddock, S. A. (1994). *Institutional owners and corporate social performance*. Academy of Management Journal, 37, 1034–1046.

13. Hatch, NW - JH Dyer (2004). *Human capital and learning as a source of sustainable competitive advantage*. Strategic Management. Journal, 25: 1155–1178
14. Holliday, C. O. – Schmidheiny, S. – Watts, P. (2002). *Walking the Talk - The Business Case for Sustainable Development*. Greenleaf Publishing, Berrett-Koehler Publishers, Inc. San Francisco.
15. Idowu, S. O. (2013). *Encyclopedia of Corporate Social Responsibility. Springer, New York ISBN 978-3-642-28035-1*
16. Ingham J. (2007). *Strategic human capital management: Creating value through people.* Oxford, Gd – Butterworth-Heinemann
17. International Federation For Human Rights (2006). *An Overview of Corporate Social Responsibility in Hungary*. FIDH, Budapest.
18. Juhász P. (2005). *A szellemi tőke szerepe és megítélése a magyar vállalatok működésében*. Budapesti Corvinus Egyetem, Vállalatgazdaságtan Intézet, Műhelytanulmányok
19. Kun, A. (2004). *The basic lines of the thematization of corporate social commitment in the European Union*. (A vállalati szociális elkötelezettség tematizálásának alapvonalai az Európai Unióban.) Jogelméleti szemle (http://www.jogiforum.hu/folyoiratok/11/68)
20. Laasch, O., Conaway R. N. (2015). *Principal of Responsible Management- Glocal Sustainability, Responsibility and Ethics*. Cengage Learning, Stamford, USA ISBN 978-1-285-08026-0
21. Lakatos Gyula (2005). *Az emberi tőke – Az önismeret gazdaságtana*. Balassi kiadó, Budapest
22. Lazear E.P. (2006). *A humán erőforrások közgazdaságtana vállalati vezetők részére*. Nemzeti Tankönyvkiadó
23. Machlup, F. (1982). *Beruházás az emberi erőforrásokba és a produktív tudásba*. In: Változások, váltások és válságok a gazdaságban. (Szerk. Schmidt Ádám-Kemenes Egon) Bp. KJK.
24. Segal, J-P. - Sobczak, A. - Triomphet C-A. (2003). *Corporate social responsibility and working condition.* European Foundation for the Improvement of Living and Working Conditions, Dublin.
25. Sen, S., Bhattacharya, C. B., & Korschun, D. (2006). *The role of corporate social responsibility in strengthening multiple stakeholder relationships*. Journal of the Academy of Marketing Science, 34, 158–166.
26. Szlávik, J. (2009). *Corporate Social Responsibility*. (In Hungarian: A vállalatok társadalmi felelősségvállalása.) Complex Kiadó Kft., Budapest.
27. Templar, R. (2005). *The rules of management the definitive guide to managerial success.* Pearson Education Limited.
28. Thomas O. Davenport (1999). *Human capital What It Is and Why People Invest It?* Jossey-Bass Pulishers, San Francisco
29. Vogel, D. (2006). *The Market for Virtue - The Potential and Limits of Corporate Social Responsibility*. Brookings Institution Press, Washington, D. C.
30. http://globalcompactfoundation.org/
31. www.iisd.org
32. www.globalreporting.org
33. http://www.iso.org/
34. http://www.efqm.org/
35. http://www.undp.org/content/undp/en/home/mdgoverview/post-2015-development-agenda.html

INTELLECTUAL PROPERTY PROTECTION AND OLYMPIC GAMES

Patrik Klimko
University of Economics in Bratislava, Slovakia
patrik.klimko@euba.sk

Anetta Caplanova
University of Economics in Bratislava, Slovakia
anetta.caplanova@euba.sk

ABSTRACT

Since recently sport has been recognized by the public and policy makers as a world-wide commercial activity. Despite the importance of protecting intellectual property in an appropriate manner, many athletes, sport clubs and sport brands do not sufficiently focus on addressing the intellectual property right related issues. The major sport commercial activities are branding, licensing and merchandising. The paper discusses various types of intellectual property rights relevant for sport, the ways to protect them and to use them efficiently. The discussion reflects the stipulations of Nairobi Treaty ratified in 1982, specifying Olympics intellectual property such as Olympic symbol, flag, motto, emblems, etc. There are still many countries that have not ratified the Treaty, but they participate in the Olympics such as the USA, United Kingdom, Germany, etc. Undoubtedly, a lot of countries protect Olympics symbols although Nairobi Treaty wasn´t ratified by them. Hosting the Olympic Games is a unique opportunity and a challenge for each country in cooperation with International Olympic Committee to show how to set up the most effective world-wide marketing strategy. IOC in cooperation with National Olympic Committees has introduced various legal standards. IOC and NOCs strongly focus on managing local and domestic sponsorships, licensing programs and ticketing in a host country reflecting also upon the intellectual property protection. In the paper we look at selected Olympics with regard to their intellectual property protection policies. We conclude that the biggest challenge for the IOC and the NOC were the Olympic Games in China, where the general IPR infringements occurred long before the Olympics even started.

Keywords: *intellectual property rights, Olympics, sport, intellectual property protection*

1. INTRODUCTION

Sport is an integral part of human activities. It can attract a massive audience for a relatively long period of time. Athletic contests around the world have been a way for individuals, institutions, cities, and nations to define themselves for a long time. Sport can bring out the best and the worst in people. As early as in the 19th century universities used football to give their students a sense of identity. Cities feel that they have achieved “big time” status once they have attracted a major league franchise. At the national level, Japan´s performance in the 2011 Women´s World Cup provided a much-need lift to a country devastated by the earthquake and tsunami and shaken by a near nuclear disaster (Leeds, Allmen, 2015).

IPRs are very closely connected to sport activities. As long as the first league was established, there always have been best league players. Each club wanted to draft them to attract more people to audience. This was the start of the creation marketing and it was closely connected with the IPR. The first sportsman, who got the endorsement deal, was the golf player Gene Sarazen. In 1922 he signed first contract in the history of sport with Wilson Sporting Goods and it was also the longest running endorsement deal (for 75 years) until his death in 1997.

2. MAJOR SPORT COMMERCIAL ACTIVITIES

Major sport commercial activities are linked to branding, licensing and merchandising. Sport branding includes the name, logo and symbols associated with the sport organization (Mulin et al., 2014, p. 161; Adjouri, Stastny, 2006 p. 108-118). In sport, the branding represents a crucial element of each sport club. From the color of their jerseys to creating slogans, there are various ways how to profit from the sport brand. However, there is a substantial difference between sport clubs such as Real Madrid or FC Barcelona, which represent sport brands, but their income activities are mostly related to players, respectively club performance in national league or in international league (e.g. Champions League brand) and sport brands like Nike, Adidas or Reebok, which are typical sport brands recognized worldwide because of the quality of their products.

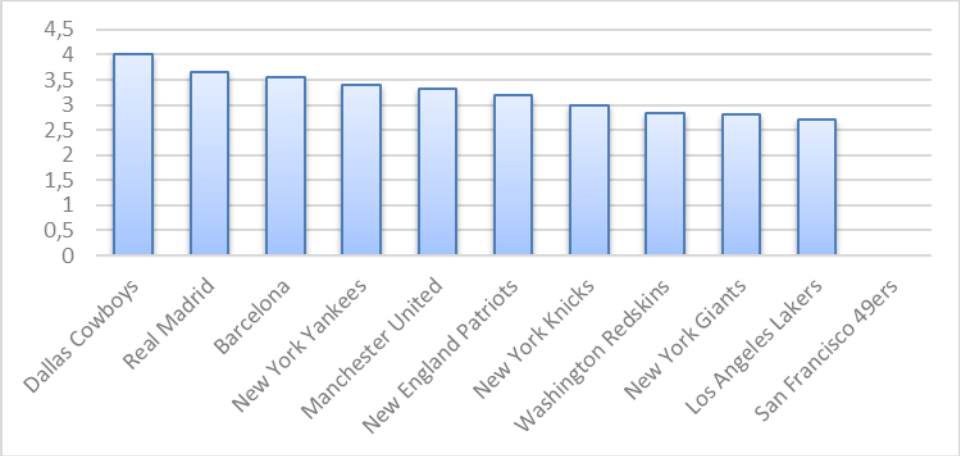


Chart 1: The most valuable sport teams in billion USD (Badenhausen, 2016)

Licensing is the process of granting or getting the permission to have, produce, or use something that another person or company has created or owns (Cambridge Dictionary, 2017). It is the process allowing legal protection of name, logo, trademark, graphical design, slogan, signature, etc. Four major North American Leagues created licensing arms, MLB Properties, NBA Properties, NFL Properties and NHL Enterprises were created to oversee the sale of "official" team paraphernalia to fans. In 2010 the revenues from licensing from the MLB reached $2.75 billion USD. The NFL follows MLB very closely with $2.70 billion USD licensing revenue. The NBA had income of $1.75 billion USD and surprisingly, the NHL had revenue from licensing of $0.63 billion USD (Leeds, Allmen, 2015, p. 97).

Chart 1: The most valuable licensing agreements in sports in billion USD (Leed, Allmen, 2015, p. 97)

The term merchandising means selling products connected with a popular film, singer, event, etc, or the activities of making people aware of these products and increasing sales through advertising, special events, etc. (Cambridge Dictionary, 2017). Following to sport brands, there are many clubs connected with names of famous sportsmen (e.g**.** FC Barcelona with Lionel Messy). The name of the sportsman itself generates large fraction of income of the related sport club.

3. NAIROBI TREATY

All countries, which are signatories of the Nairobi Treaty are under the obligation to protect the Olympic symbol – five interlaced rings – against its use for commercial purposes without the authorization of the International Olympic Committee (IOC) (e.g. in advertisements, on goods, as a symbol, etc). An important consequence of the Treaty is that, if the International Olympic Committee grants authorization to use the Olympic symbol in a country, which is a signatory to the Treaty, the National Olympic Committee of that country is entitled to receive a part of any revenue that the International Olympic Committee obtains from granting this authorization. The Treaty does not provide for the institution of a Union, governing body or budget. The Treaty is open to any country, which is a member of World Intellectual Property Organization (WIPO), the Paris Convention for the Protection of Industrial Property (1883), the United Nations or any of the specialized agencies brought into relationship with the United Nations. Instruments of ratification, acceptance, approval or accession must be deposited with the Director General of WIPO (Nairobi Treaty, 1981).

There exists relatively clear explanation of the IPR related to the Olympics symbols. IOC owns all symbols and it is able to grant these rights to any other party, which is clearly linked to taking part of the Olympic Games. Organizing Committee of the Olympic Games (OCOG) manages Olympic Games licensing programs under the direction of the IOC. (Olympic Marketing Fact File, 2016, p. 29).

Despite the fact that not all countries ratified the Nairobi Treaty (e.g. United Kingdom), each host city, OCOG and National Olympic Committee have to sign the commitment to it before the Olympic Games and have to comply with all IOC regulations.

4. COMMERCIAL ACTIVITIES OF INTERNATIONAL OLYMPIC COMMITTEE

According to the recent study about 93 percent of global population are aware of the Olympic rings - making this symbol the most widely recognized of all brand symbols surveyed. (Annual Report, 2014, p. 39). The main ICO commercial activities are related to broadcasting rights, sponsorship, ticketing and licensing. The highest income in quadrennium 2013-2016 is obtained from broadcasting rights (47 percent). The revenue from sponsorship comprises 45 percent and the revenue from ticketing is only 5 percent. The lowest income from main ICO commercial activities is raised from licensing (3 percent) (Annual Report, 2014, p. 112). The income from broadcasting rights has been rising. In 2015 the ICO Annual report reported the forecast for quadrennium 2013-2016, which shows the change in terms of broadcasting rights. The forecast expect the income from broadcasting rights at the level of 74 percent, which equals to $4.14 billion USD, in difference to the 2014 forecast, which forecasted it at the level of 47 percent ($2.63 billion USD). The extensive change took place also in terms of sponsorship. In 2014 it comprised 45 percent, which was equal to $2.52 billion USD. In 2015 it comprised only 18 percent, which equaled to $1 billion USD. The ticketing and licensing revenues were almost the same at the level of 5 percent, or 3 percent respectively in 2014 and at the level of 4 percent from ticketing and 4% from licensing in 2015.

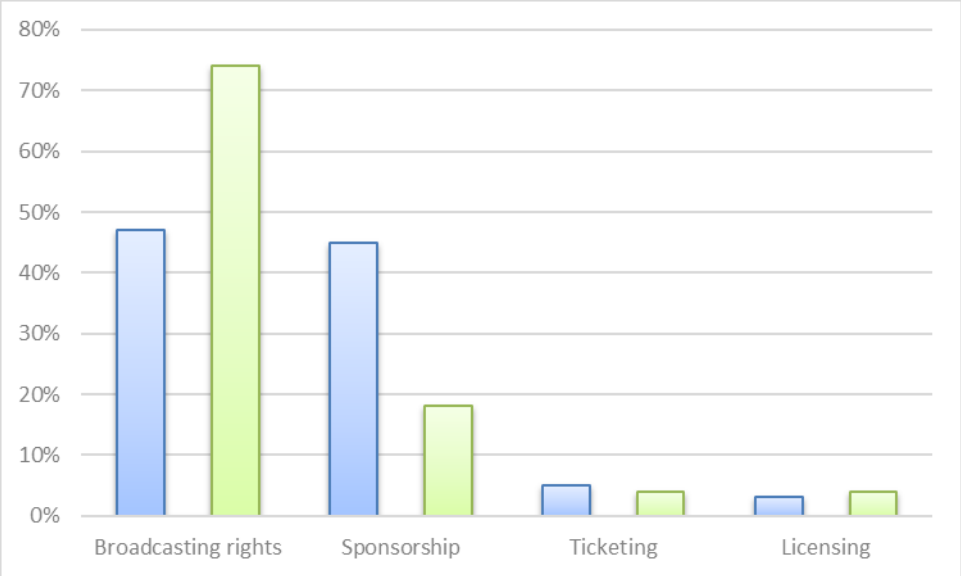


Chart 2: IOC total revenues in billion USD (IOC Annual Report, 2015, p. 128; IOC Annual Report, 2014, p. 39)

The IOC official supplier and licensing programme generates in each quadrennium (2001-2004; 2005-2008; 2009-2012) about the same percentage of the total revenues (3 percent). However, its nominal value has been increasing, in the period 2001-2004 it represented only $90 million USD, in the next quadrennium it was already $117 million USD and in the period 2009-2012 it reached $156 million USD. The forecast for the most recent 4-year period (2013-2016) the total revenues from the Olympics IPR were expected to reach up to $224 million USD (see table 1).

For example, during the London Olympics (2012) there was the biggest product range offered in the Olympic history (together with Beijing 2008) and 10,000 different product lines across 20 product categories were offered for sale. The sales of these products generated almost GBP 1 billion in retail sales (London Final report, 2012, p. 64). In Beijing 2008, over 7,000 different kinds of licensed products were offered, which were developed for the Olympics 2008. These can be divided into 10 product categories ranging from badges to flags, banners and handicrafts (Beijing Final report, 2008, p. 80). This also points to the increasing role of IPR protection in case of big sport events such as Olympic Games.

Table 1: IPR revenues versus Total revenues during selected Olympic Games in billion USD (IOC Annual Report 2015, p.129; IOC Annual Report, 2014, p. 112)

Olympics	Quadrennium	Total revenues	IPR revenues
Salt Lake City, Athens	2001-2004	3	0.09
Turin, Beejing	2005-2008	3.9	0.117
Vancover, London	2009-2012	5.2	0.156
Sochi, Rio De Janeiro	2013-2016	5.6	0.224*

Note: *forecast

5. BEIJING OLYMPIC GAMES AND INTELECTUAL PROPERTY RIGHTS PROTECTION

In 2001 the Beijing Organising Committee of the Olympic Games (BOCOG) and IOC signed the document, which was focused at protecting the Olympic symbols in China against any commercial exploitation without the consent of the BOCOG, of the Chinese Olympic Committee (COC) and of the IOC approval. The protection extended to Olympic rings, flag, motto, emblem and, unusually, also the anthem. Also, the words 'Olympic', 'Olympiad' and 'Olympic Games' and the emblems of the Chinese Olympic Committee and of the Beijing Games 2008 were protected. The rights for the use of all these emblems belonged jointly to the IOC, the OOC and the BOCOG and can be used in accordance with the Host contract. These rights prohibited the use of the Olympic symbols on packaging, in services, advertising and profitmaking performances and other activities, which would suggest sponsorship or a supporting relationship with the Olympics (Johnson, 2009, p. 18). However, in spite of the effort to protect IPRs during the Olympics, During the Olympics in Beijing in 2008, the Li Ning affair was one of the biggest issues related to the Intellectual property rights protection. Li Ning was chosen for torch relay during the Opening ceremony. Because he was wearing clothing of a lesser-known Chinese sportswear company called Li Ning most spectators assumed that Li Ning brand was the official sponsor of Olympics. Since the Adidas was the official sportswear partner of these Olympics, this case raised the question, how the IOC was able to protect IPR in China (Leyland et al., 2010, pp. 281-289). During the Beijing Olympics Article 2 of the Regulations identified six categories of Olympic IPR mirroring the requirements of the Olympic Charter and the Beijing Host City Contract. The term "Olympic Symbols" was used in the Regulations as an embracing term referring to all Olympic IPRs rather than simply the five interlocked rings commonly referred to as the "Olympic Symbol". The Regulations defined the Olympic Symbols to include not only words, signs and other aspects normally trademarked, but also those objects customarily protected by copyrights (such as medal designs, databases and statistics relating to the Games). The first five sub-items of Article 2 (Candidature file, 2000) identified specific elements of the Olympic Symbols, while the sixth sub-item was meant to encompass all other elements of the Olympic IPRs referenced under the Olympic Charter and Host City Contract. This catch-all provision created compliance problems, however, since the Host City Contract is not a publicly available document and therefore, the general public does not have access to information on what is, or what is not restricted. Problems may also arise due to the fact that the government enforcement agencies themselves did not know the content of the Host City Contract. Although Article 7 (Candidature file, 2000) was apparently intended to alleviate the ambiguity by providing that the Olympic Symbols be filed with the government, there always remains the risk that third parties may unintentionally violate the Regulations by using Olympic Symbols that were not publicly identified prior to such use. In order to eliminate this risk, the State Council should issue supplementary guidelines that clearly identify the entire scope of the Olympic Symbols - either by listing the items covered under the Host City Contract with sufficient specificity, or by providing that the filing procedure identified in Article 7 was a pre-requisite to enforcement (Fendel, 2003, p. 33)

6. CONSLUSION

The three major sport commercial activities branding, licensing and merchandising have significant market value. However, the value of each of them is different for each sport brand. Since the sport industry is growing and football clubs (especially in Europe) are becoming more and more popular, the commercial value of the sport teams has also been rising. The Nairobi Treaty protects the Olympic symbol. Since 1982, not all countries, which have been chosen for hosting the Olympics ratified the Nairobi Treaty, but all of them had to sign the

commitment to respect it. Also, they have to respect all regulations from the IOC. In quadrennium the IOC income from the licensing is estimated at *$*224 million USD. The IOC symbol and the Olympic rings are most widely recognised of all brand symbols in the world. Each host city, each OCOG and National Olympic Committee have to agree and respect IOC regulation. Despite the problems with IPR protection in China 2008, IOC, BOCOG and COC and especially the government of the China made big effort to protect the symbols and to minimize the amount of the black market activities related to the Olympic symbols, emblems, anthem, logo, etc. and breach of the IPRs related to them. In spite of the effort to do so the protection of IPRs related to big sport events remains one of the challenges of the big sport events and of the the commercialisation of products launched on the market in relation to them.

LITERATURE:

1. Badenhausen, K. (13.06.2016). Dallas Cowboys Head The World's 50 Most Valuable Sports Teams Of 2016. *Forbes*. Retrieved 11.05.2017 from https://www.forbes.com/sites/kurtbadenhausen/2016/07/13/dallas-cowboys-head-the-worlds-50-most-valuable-sports-teams-of-2016/#4789a856f330
2. Beijing Final Report. (2008). *Summer Olympic Games official report Beijing 2008*. Retrieved 14.5.2017 from: https://www.google.sk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwiy2uyOvu_TAhWDfRoKHWJbCD4QFggoMAA&url=https%3A%2F%2Fstillmed.olympic.org%2FDocuments%2FReports%2FOfficial%2520Past%2520Games%2520Reports%2FSummer%2FENG%2F2008-RO-S-Beijing-vol3.pdf&usg=AFQjCNHGfS73SVMYg2fLghHYJIkupPJY5Q&sig2=oqYU-3DipQA_bO7gveS_yg
3. Cambridge Dictionary. (2017). *Cambridge Business English Dictionary*. Retrieved 14.5.2017, downloaded from: http://dictionary.cambridge.org/dictionary/english/licensing
4. Candidature file. (2000). *Beijing organizing committee for the Games of the XXIX Olympiad, Beijing candidature file 39*, Retrieved: 7.3.2015 from: http://en.beijing2008.cn/65/68/column211716865.shtml
5. Fendel, F. (2003). Protecting Olympic Intellectual Property. *China Law and Practice*, pp. 33-34, Beijing.
6. Johnson, P. (2009). *Intellectual property and sport: Section C: Ambush marketing*. London: University of London Press
7. Leeds M.A., Allmen P. (2015). *The Economics of Sports*. Harlow: Pearson Education Limited.
8. Leyland, P. et al. (2010). Event sponsorship and ambush marketing: Lessons from the Beijing Olympics. *Elsevier, Business Horizon*, Indiana University, pp. 281-290.
9. London Final Report. (2012). *Final report of the IOC Coordination Commission*. Retrieved: 11.5.2017 from: https://www.google.sk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0ahUKEwi59refu-rTAhVD6CwKHdlgBooQFgguMAE&url=https%3A%2F%2Fstillmed.olympic.org%2FDocuments%2FGames_London_2012%2FFinal%2520Cocom%2520Report%2520London%25202012%2520EN.pdf&usg=AFQjCNFyEdD_0bGJtGbeepsFwYXMj9ObpQ&sig2=keqMZZBlpyB4_ZMYmdokyQ
10. Mulin, B., Hardy, S., Sutton, W. (2014). *Sport Marketing, 4th Edition with Web Study Guide*, Cloth Pass/Kycd: Human Kinetics
11. Nairobi Treaty. (1981). *Nairobi Treaty on the Protection of the Olympic Symbol*, 3 p.
12. Olympic Marketing Fact File 2016. (2016). *Olympic Marketing Fact File*. Retrieved 11.5.2017 from: https://stillmed.olympic.org/media/Document%20Library/OlympicOrg/Documents/IOC-Marketing-and-Broadcasting-General-Files/Olympic-Marketing-Fact-File-2016.pdf#_ga=2.38146784.2118989846.1494595524-866276304.1494595214

SKILLS AND COMPETENCIES OF FORENSIC ACCOUNTANT: EVIDENCE FROM CROATIA

Marijana Bartulovic
University Department of Forensic Sciences, Ruđera Boškovića 33, 21000 Split, Croatia
marijana@unist.hr

Ivica Filipovic
University Department of Forensic Sciences, Ruđera Boškovića 33, 21000 Split, Croatia
ifilipov@unist.hr

ABSTRACT

Forensic accountants play an extremely important role in preventing and detecting fraud, and demand for this profession has increased after a number of corporate scandals (such as Enron, WorldCom, Satyam etc.) that have raised public awareness on the issue of fraud and fraudulent financial reporting. The profession of forensic accountant is an interdisciplinary profession where one of the primary tasks is fraud prevention and detection. However, persons engaged in this area can provide a full range of other services, such as assessing the economic value of assets and liabilities, detecting tax irregularities, expert witnessing in court proceedings, preventing corruption and similar services. In the context of providing complex services in the area of forensic accounting, besides accounting and auditing skills, knowledge of law and investigative techniques is also required. Along with a full range of knowledge and skills that persons engaged in financial and accounting forensics should possess, they should also have certain experience and continuously improve their knowledge and skills. In this paper, authors present the results of research conducted on a sample of 38 experts about the knowledge and skills of forensic accountants in the Republic of Croatia. Analysis of required knowledge and skills of forensic accountants was conducted through "A survey about the occupational standard" in the context of development of occupational standard for the profession of forensic accountant at the University Department of Forensic Sciences in the period from July till September 2016.

Keywords: *frauds, forensic accountant, skills and competencies*

1. INTRODUCTION

Accounting scandals such as Enron, WorldCom and many others, as well as the collapse of Arthur Andersen, one of the largest audit companies, have raised public awareness on fraud and fraudulent financial reporting, and have spurred the development of a new branch of accounting - forensic accounting. Today, forensic accounting has a major role in preventing and detecting frauds and it represents one of the fastest growing areas within the accounting profession since. Almost in all areas of business there is a need for services of these experts. The area of forensic accounting and the profession of forensic accountant are interdisciplinary areas where accounting and auditing skills are required as well as knowledge of law and investigative techniques. Profession of forensic accountant is, in global terms, a relatively new profession, and in the Republic of Croatia this profession, as a profession with its specific knowledge and skills is not yet completely recognized. In this context, at the University of Split, University Department of Forensic Sciences, the process of development of occupational standard and affirmation of this profession, both in Croatia and in neighboring countries, was initiated. Research on the characteristics of the profession of forensic accountant was conducted through "A survey about the occupational standard" in the period from July to September 2016. The study included 38 experts who are familiar with the tasks in the profession of forensic accountant: auditors, court experts in the field of finance

and accounting, internal auditors, inspectors and lawyers who use the services of forensic accountants.
The aim of the study was to collect data about the basic features of the profession such as: the key tasks in the profession, competencies required to perform key tasks, information about generic skills, psychomotor skills, required level of education and the characteristics of the workplace. This paper shows the part of the research related to key tasks and knowledge and skills required in the profession of forensic accountant.

The paper is structured as follows. After the introductory part, within the second chapter, selected studies which analyze the knowledge and skills required for performing tasks of forensic accountant are presented. In the third part of the paper, the results of empirical research on competencies of forensic accountant in the Republic of Croatia are presented, while in the last part of the paper concluding remarks are presented.

2. SKILLS AND COMPETENCIES REQUIRED IN FORENSIC ACCOUNTING

One of the main characteristics of forensic accounting, as specific area of accounting profession is its interdisciplinary approach, which implies the interdisciplinary knowledge of experts who are engaged in this area. Experts who specialize in the area of business forensics and forensic accounting should be familiar with accounting, auditing and law and should also possess certain investigative skills. In this part of the paper the authors present selected studies which analyze knowledge, skills and characteristics that a forensic accountant should possess. Aderibigbe (2000) states that a person who is engaged in forensic accounting should have a high level of competence, integrity and sincerity in order to successfully perform his job. Furthermore, the author considers that forensic accountants must be well trained in their work and demonstrate competence by acquiring the relevant professional certificates. According to Bhasin, besides accounting knowledge and skills that it takes to perform audit activities, forensic accountant should possess specific skills such as the ability to pay attention to the smallest detail, analyze data thoroughly, creative and rational thinking, computer skills and excellent communication skills (Bhasin, 2007, p. 1006). In defining the skills and characteristics of forensic accountant, it is often pointed out that people working in this area should have expressed professional skepticism which helps to identify warning signs or red flags. In gathering evidence and fraud research forensic accountants should therefore believe in the "sixth sense" and check their doubts. According to a survey conducted by DiGabriele (DiGabriele, 2008, p. 331-338) experts and scientists with expertise in the area of forensic accounting agree that critical thinking, solving unstructured problems, flexibility in research, analytical skills and knowledge of legal framework are essential skills of forensic accountants. Also, as essential skills, especially in cases of court expertise, communication skills are highlighted.

In 2009, the American Institute of Certified Public Accountants (AICPA), conducted extensive research in order to determine characteristics and skills of forensic accountants (AICPA, 2009, p. 1-31). The study was conducted on a sample of 779 participants (lawyers, certified public accountants and professors in the field of accounting and auditing) and the aim of the research was to determine the perception of participants on occupation of forensic accountant as well as the knowledge and skills required to make a person effective forensic accountant. Within the research, participants were asked to define features of forensic accountants related to essential traits and characteristics as well as those referred to core and enhanced skills. Results of conducted research show that there is a considerable gap in the understanding of the knowledge and skills of forensic accountants between different groups of participants. As one of the essential traits and characteristics of forensic accountants

analytical skills have been pointed out. Furthermore, as essential traits and characteristics of forensic accountant attention to detail, ethics and curiosity were listed. Apart from the essential traits and characteristics of forensic accountants, the authors also analyzed the core knowledge and skills that a forensic accountant should possess. In this area there is also lack of consensus between different groups of participants. Lawyers emphasized the ability of effective oral communication as primary skill of forensic accountants while professors and certified public accountants emphasized the ability to think critically as the most important skill of forensic accountants. Furthermore, as important skills that a forensic accountant should possess, the ability of simplifying information, auditing and investigative skills as well as effective written communication were pointed out. Besides core skills, enhanced skills of forensic accountants were also analyzed. As part of enhanced skills of forensic accountant, analysis and interpretation of financial statements, fraud detection skills, interviewing skills and testifying were highlighted. Furthermore, as important enhanced skills of forensic accountant, following skills were pointed out: knowledge of relevant professional standards, knowledge of audit evidence, asset tracing, electronic discovery and general knowledge of rules of evidence and civil procedure (AICPA, 2009, p. 11). McMullen and Sanchez have conducted research in the United States, on a sample of 159 participants who are professionally engaged in fraud research (McMullen & Sanchez, 2010, p. 30-48). All the knowledge and skills that were analyzed in the context of research were assessed as relevant for the profession of forensic accountant. However, as the most important skills that a forensic accountant should possess, following skills were pointed out: analytical skills, accounting skills, problem solving skills, data analysis skills and interviewing skills. As the most important characteristics of forensic accountant, persistence, skepticism, "puzzle" skills, "people" skills and flexibility have been emphasized. Chen and Akkeren (2012) claim that forensic accountants should have a wide range of competencies. However, they emphasize skills relating to business valuation, testifying, quantification of loss, litigation support, financial investigation and analysis, risk assessment, E-discovery, provision of due-diligence reporting and dispute advisory as important competences of forensic accountants (Chen & Akkeren, 2012, p. 18). Bhasin conducted a research in India in the period 2011-2012 on a sample of 120 participants in order to determine skills of forensic accountants as well as differences in the perception of the relevant skills of forensic accountants between different groups of participants. The respondents were classified into three groups: providers of accounting services, professors from the field of accounting and users of forensic accounting services. The research results showed that the respondents emphasized written and oral communication and auditing skills as the most important skills of forensic accountants. Furthermore, the results suggested that forensic accountants should also, along with core skills, possess the skills from other areas, such as from other social sciences like law (Bhasin, 2013, p. 79). The Technical Working Group for Education in Fraud and Forensic Accounting pointed out the following knowledge and skills as prerequisites for continuing education in the field of forensic accounting,: basic accounting knowledge, basic auditing skills, knowledge of the business cycles and the control environment, knowledge of the concepts of commercial law, business ethics, basic computer skills and communication skills (West Virginia University, 2007, p. 12). Based on the above stated, it can be noted that there is a lack of consensus in terms of knowledge and skills of forensic accountants and in the existing literature different skills and knowledge that people who deal with this area should possess are listed. Such findings are not surprising considering the interdisciplinarity of this area and the fact that the knowledge and skills of forensic accountants represent the synergy if innate traits and acquired knowledge and skills which are the result of formal education and years of experience in the field of forensic accounting.

3. RESEARCH RESULTS ON SKILLS AND COMPETENCIES OF FORENSIC ACCOUNTANT: CASE OF CROATIA

In this part of the paper, part of results of research conducted in the context of development of occupational standard for the profession of forensic accountant at the University Department of Forensic Sciences, University of Split is presented. Analysis of required knowledge and skills of forensic accountants was conducted through "A survey about the occupational standard" in the period from July till September 2016. The study included experts who are familiar with the tasks in profession of forensic accountant: auditors, court experts in the field of finance and accounting, internal auditors, inspectors and lawyers who use the services of forensic accountants. Finally, the study included 38 participants, and the structure of participants is shown by Figure 1.

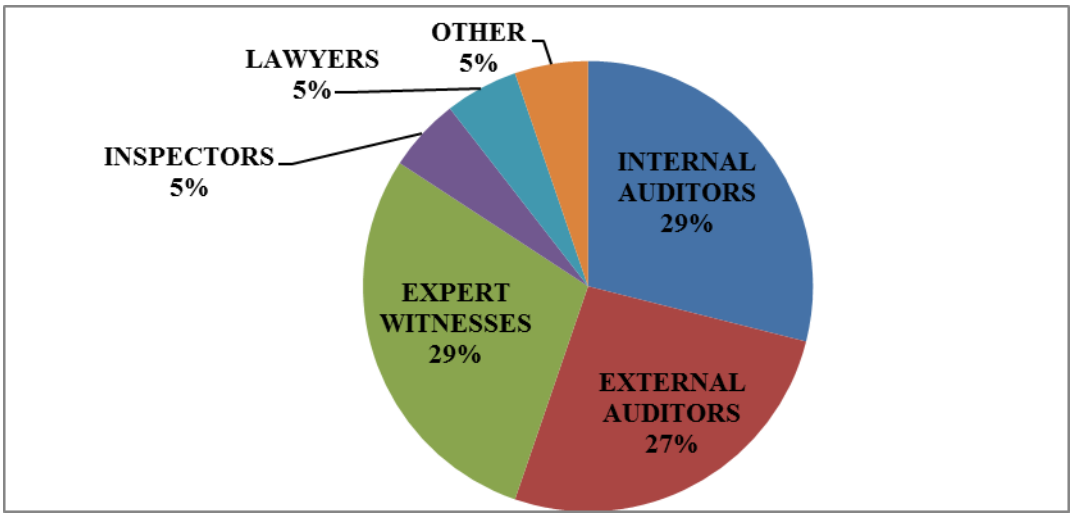


Figure 1: Structure of participants (author ')

The aim of the research was to collect data about the basic features of the profession such as: the key tasks in the profession, competencies required to perform key tasks, information about generic skills, psychomotor skills, required level of education and the characteristics of the workplace.

Within this paper, a part of the research related to key tasks and knowledge and skills required in the profession of forensic accountant is presented. In the survey about the occupational standard, employers were asked to list the key jobs performed by experts in the profession of forensic accountant (maximum of 6 key jobs), and then, for each key job, they should define up to five competencies (knowledge and skills) that an expert should possess in order to successfully carry out the key tasks. Furthermore, for each of these competencies, employers could state whether these competencies are acquired through work experience or through formal education and whether they consider that the need for that competence over the next five years will increase, remain equal or decrease. The obtained results are shown below.

For the profession of forensic accountant the participants defined 64 different key jobs that are grouped into 14 groups of key jobs that merge closely related statements. The key jobs identified in the occupation of forensic accountant are presented in Table 1.

Table 1: Groups of key jobs in the profession of forensic accountant (University Department of Forensic Sciences, 2016, p. 15)

No.	Group of key job	Number of statements of key jobs	Number of statements of knowledge and skills	Number of employers that listed a key job
1	Litigation support	4	39	28
2	Discovering fraud or intention of fraud	9	32	20
3	Asset valuation	4	14	18
4	Discovering tax evasion	4	20	13
5	Fraud prevention	4	14	12
6	Assessing financial position	7	23	8
7	Controlling the accuracy and reliability of the documentation	8	19	7
8	Reporting	5	12	7
9	Consulting services	6	19	6
10	Education and training	4	9	5
11	Planning forensic analysis	3	13	4
12	Other jobs	4	9	3
13	Preventing and detecting money laundring	1	9	2
14	Combating corruption	1	5	1
	Total*	**64**	**237**	**10**

*number of statements of key jobs and number of statements of knowledge and skills under Total is presented as sum, and number of employers who listed key jobs is presented as average.

For 64 listed key jobs employers defined 237 required skills and competencies and listed key jobs were recognized by 10 employers on average. The largest number of participants, 28 or 74% of them, defined Litigation support as a key job of forensic accountant, while only one employer defined Combating corruption as a key job of forensic accountant. In the second place, as the key job of forensic accountant, participants indicated Discovering fraud or intention of fraud, and first five recognized jobs of forensic accountants also include Asset valuation, Discovering tax evasion and Fraud prevention. Furthermore, as jobs relevant in the profession of forensic accountant, employers also listed: Assessing financial position, Controlling the accuracy and reliability of the documentation, Reporting, Consulting services, Education and training, Planning forensic analysis, Preventing and detecting money laundring, Combating corruption and other jobs. Based on the above mentioned key jobs, it can be concluded that the range of services that can be provided by forensic accountants is

quite broad and that the key jobs differ depending on the specific workplaces within profession and on different roles and responsibilities of these experts. Furthermore, in the context of research, knowledge and skills that forensic accountant should possess in order to successfully perform key jobs within the profession, were also analyzed. For the profession of forensic accountant the participants defined a total of 145 knowledge and skills that are considered relevant for performing certain key jobs. The statements about knowledge and skills are grouped in 18 groups of knowledge and skills noting that key or generic competences are not individually separated but are grouped in the same way as other knowledge and skills that the participants pointed out as relevant. Key or generic competences include: information literacy, analytical, systematic and logical thinking, recognition and management of priorities, risk taking, public performance, communication and presentation skills and knowledge of foreign (English) language.

Table 2: Groups of knowledge and skills in the profession of forensic accountant (University Department of Forensic Sciences, 2016, p. 15)

GROUP OF KNOWLEDGE AND SKILLS	**NUMBER OF STATEMENTS OF KNOWLEDGE AND SKILLS**	**NUMBER OF EMPLOYERS WHO LISTED SOME KNOWLEDGE AND SKILL**	**THE WAY OF OBTAINING KNOWLEDGE AND SKILLS**			**NEED FOR KNOWLEDGE AND SKILLS IN THE NEXT 5 YEARS**		
			education	training	both	less	more	equal
Communication skills	17	25	16%	60%	23%	0%	65%	35%
Preparing forensic reports	7	25	4%	82%	14%	0%	82%	18%
Knowledge of financial reporting standards	8	22	26%	48%	26%	0%	70%	30%
Skills of collecting and evaluating evidence	13	21	14%	78%	7%	0%	71%	29%
Knowledge of evaluation models of different types of assets	7	19	78%	12%	9%	0%	86%	14%
Knowledge of the tax system	7	17	39%	44%	17%	2%	54%	44%
Legal knowledge	4	17	22%	56%	22%	0%	78%	22%
Financial statements analysis skills	5	16	30%	45%	25%	0%	50%	50%
Risk assessment	4	16	13%	74%	13%	0%	30%	70%
Knowledge of methods and techniques of forensic analysis	6	15	58%	29%	13%	0%	25%	75%
Knowledge of financial statements	2	14	63%	26%	11%	0%	63%	37%
Evaluation of the internal control system	8	13	22%	76%	2%	0%	37%	63%
Knowledge of business processes	16	12	11%	68%	21%	0%	54%	46%
Auditing knowledge and skills	9	12	41%	50%	9%	0%	82%	18%
Analytical and research skills	13	9	36%	55%	9%	5%	23%	73%
Computer forensic skills	6	7	38%	38%	25%	0%	13%	88%
Knowledge of the payment system	11	6	42%	42%	17%	0%	25%	75%
Others	2	3	20%	40%	40%	0%	20%	20%
Total*	**145**	**-**	**32%**	**51%**	**17%**	**0%**	**52%**	**48%**

*number of statements of knowledge and skills under Total is presented as sum, and the number of employers who listed some knowledge and skill and percentages is presented as average.

The largest number of employers, 25 of them, pointed out Communication skills and Preparing forensic reports as key competencies of forensic accountants, while competencies classified into the group Others were listed by the lowest number of employers, 3 employers. 51% of employers who participated in the research consider that a significant part of the knowledge and skills required to perform jobs of forensic accountant are gained through working experience, 32% of employers believe that knowledge and skills are acquired through education and the remaining 17% believe that acquiring competencies for performing jobs in this area requires combination of both methods of learning. Thus, according to the research results, providing services in the field of forensic accounting, requires proper formal education but however, the participants point out that a significant part of the required competences is gained through a work experience which is consistent with previous research in this area (for example McMullen & Sanchez, 2010, Chen & Akkeren, 2012). Most employers, 52% of them, believe that in the future the demand for the competences of forensic accountants will increase, while other 48% of employers consider that the demand for these knowledge and skills will remain the same. Such results are in line with the global trends in this area (AICPA, 2011, Chiang, 2013). It should be noted that all employers point out equal or greater need for these competences in the future and that no one considers that the demand for knowledge and skills of forensic accountants will decrease in the future.

In the first five groups of knowledge and skills of forensic accountants, following skills were pointed out: Communication skills, Preparing forensic reports, Knowledge of financial reporting standards, Skills of collecting and evaluating evidence and Knowledge of evaluation models of different types of assets. Communication skills, such as data presentation, participation in court procedures, interviewing skills, accuracy and unambiguousness in expression, were pointed out by the largest number of employers, 25 of them, in 17 different statements of knowledge and skills. For this group of competencies most employers, 60% of them, consider that competencies are gained through work experience, 16% of employers choose education as the primary way of acquiring competencies, while 23% of employers consider that competencies in this area are gained through combination of both, education and work experience. Most employers (65% of them) consider that the demand for this group of competencies will increase in the future while other 35% consider that demand for these competencies will stay the same. Preparing forensic reports was also pointed out as an important set of competencies within the profession of forensic accountant by 25 employers. Within this group of competencies, seven skills and knowledge can be extracted (e.g. compiling a forensic report, preparing records, synthesizing the results obtained on the subject of expertise) and 82% of employers consider how these competencies are primarily gained through work experience. Also, most employers believe that in the future there will be a greater demand for these skills and knowledge. Furthermore, Knowledge of financial reporting standards (Knowledge of IFRS and CFRS, Knowledge of accounting techniques, Knowledge of accounting policies, Knowledge of accounting program) presents a group of knowledge and skills that has been identified by 22 employers in eight sets of knowledge and skills. Slightly less than half of employers, 48% of them, think that these competencies are adopted through work experience while others are divided between the other two options. Considering the need for these competences in the future, 70% of employers feel that there will be more demand for these competencies, and others feel that they will be equally needed. Highly listed are also Skills of collecting and evaluating evidence (analytically and critically judge the evidence in court proceedings, determine the relevance of the documentation, determine the adequacy of the documentation) which were highlighted by 21 employer through 13 different statements. Most employers think that these

skills are gained through work experience, and 71% of them think that the demand for these competences will increase in the future. Knowledge of evaluation models of different types of assets (e.g. The determination of lost profits, determining the appropriateness of severance pay for small shareholders, company valuation) is a group of competencies recognized by 19 employers through 7 statements of skills and competencies. Most of them, as much as 78%, consider that these competencies are adopted through education process while others are divided between the other two ways of acquiring competences. Also, 86% of employers believe that the demand for these competences will increase in the future. Furthermore, as competencies required in the profession of forensic accountants employers indicated: knowledge of the tax system, legal knowledge, business risk assessment, financial statements analysis skills, knowledge of methods and techniques of forensic analysis, knowledge of financial statements, internal control system assessment, business processes knowledge, auditing knowledge and skills, analytical and research skills, computer forensics skills, knowledge of the payment system and other knowledge and skills.

Within "A survey about the occupational standard" needs for the generic skills of forensic accountants were also analyzed. Analytical skills (M=4.71) are recognized as the most significant generic skills within the profession, and as many as 76% of respondents feel that these skills are highly needed within the profession. Hence, the emphasis is on the ability to collect and view various information and perspectives, to check the assumptions based on them and to make conclusions. In the second place, the respondents emphasized responsibility (M = 4.68), which means that the employees at the workplace of forensic accountant should perform their tasks conscientiously and properly. Furthermore, ethics and professional skepticism are also pointed out with an average rating of 4.46 and 4.45 respectively.

Therefore, respondents consider that employees within the analyzed profession should follow the rules of professional ethics in order to protect the profession and in their work they should allow all the possibilities, develop their knowledge of the fraud risks and the ability of critical judgment in evidence valuation. Furthermore, as the skills required in the profession of forensic accountant respondents also pointed out the following skills: bearing pressure, emotional self-control, focus on work results, teamwork, decision-making, adaptability, presentation skills, and organizational and planning skills.

4. CONSLUSION

Forensic accounting as a discipline integrates areas of accounting, auditing, law and investigative skills with purpose of preventing and detecting various forms of fraud, and it represents the peak of the accounting profession. In the modern business environment, there is a great demand for the profession of forensic accountants precisely because of the interdisciplinary knowledge and skills that distinguish them from traditional accountants and enable them to provide a wide range of services - from consulting services in court proceedings to valuation of different types of assets and the prevention and detection of frauds. The profession of forensic accountant is a new profession and worldwide demand for this profession is constantly growing so such trends can be expected in our environment as well. This paper presents the results of, according to our best knowledge, the first research on the competences of forensic accountants in the Republic of Croatia. The aim of the conducted research was to gain information on the profession of forensic accountant and to contribute to the development and affirmation of the profession through the preliminary definition of the key jobs and knowledge and skills that the person dealing with forensic accounting should possess.

According to the research results, the most important jobs in the profession of forensic accountant are: litigation support, discovering fraud or intention of fraud, asset valuation, discovering tax evasion and fraud prevention. It is important to point out that the respondents listed a whole range of other jobs that forensic accountants can perform, which confirms the previous research in this area and the complexity of the forensic accounting profession.

As the most important competencies of forensic accountants the respondents pointed out the following: communication skills, preparing forensic reports, knowledge of financial reporting standards, skills of collecting and evaluating evidence and knowledge of evaluation models of different types of assets. In addition to these competences, the respondents identified a whole range of other knowledge and skills required to adequately perform tasks in the domain of forensic accounting (for example knowledge of the tax system, legal knowledge, financial statements analysis skills, risk assessment, knowledge of methods and techniques of forensic analysis etc.). Results can be compared with previous research in this area (e.g. Bhasin, 2007, DiGabriele, 2008, AICPA, 2009, Bhasin, 2013) but it should be emphasized that this is a new and interdisciplinary area that is still developing and there is no unified view of theoreticians or practitioners regarding the competences of these experts.

Based on the above, it can be noticed that there is a whole range of knowledge and skills that a forensic accountant should possess and finally it can be concluded that the knowledge and skills of forensic accountant represent the synergy of innate traits and the acquired knowledge and skills that result from formal education and long experience in the field of financial-accounting forensics. Finally, it is important to emphasize that this research is a pioneering study on the profession and competencies of forensic accountants in the Republic of Croatia and it opens up space for new researches in this area through which competences and general characteristics of the profession of forensic accountant, which is in the Republic of Croatia just in its infancy, can be in more detail analyzed.

LITERATURE:

1. Aderibigbe, P., (2000), The Role of the Forensic Chartered Accountant, *The Nigeria Accountant*, July, pp. 15-20.
2. AICPA, (2009), *Characteristics and Skills of the Forensic Accountant*, Retrieved 03.04.2016. from https://www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/PractAidsGuidance/DownloadableDocuments/ForensicAccountingResearchWhitePaper.pdf.
3. AICPA, (2011), *The 2011 Forensic and Valuation Services (FVS) Trend Survey*, Retrieved 07.04.2017. from https://www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/PractAidsGuidance/
4. DownloadableDocuments/2011%20FVS%20Trend%20Survey.pdf.
5. ACFE, (2016), *Report to the Nations on Occupational Fraud and Abuse*, Retrieved 03.06.2016. from http://www.acfe.com/rttn-download-2016.aspx.
6. Bhasin, M. L., (2007), Forensic Accounting: A New Paradigm for Niche Consulting, *The Chartered Accountant*, Retrieved 23.06.2016. from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2703647.
7. Chiang, J., (2013), *Accountants Uncover Opportunity In Forensics*, Retrieved 07.04.2017. from http://media.ibisworld.com/2013/08/21/accountants-uncover-opportunity-in-forensics/.
8. Bhasin, M., (2013), Survey of Skills Required by the Forensic Accountants: Evidence from a Developing Country, *International Journal of Contemporary Business Studies*, Vol. 4. No. 2, p. 54-86.

9. Chen, Y., Akkeren, J., V., (2012), The Theory of Profession: Accountability, qualifications, entry and ethics – a preliminary discussion and early findings on the current state of forensic accountancy in Australia, Retrieved 06.04.2017. from https://business.uow.edu.au/content/groups/public/@web/@commerce/@econ/documents/doc/uow120441.pdf.
10. DiGabriele, J. A., (2008), An Emprical Investigation of the Relevant Skills of Forensic Accountants, *Journal of Education for Business*, p. 331-338.
11. McMullen, D. A., Sanchez, M. H., (2010), A Preliminary Investigation of the Necessary Skills, Education Requirements and Training Requirements for Forensic Accountants, *Journal of Forensic & Investigative Accounting*, Vol. 2, No. 2, p. 30-48.
12. University Department of Forensic Sciences, (2016), A survey about the occupational standard „forensic accountant"– Research report, Split
13. West Virginia University, (2007), Education and Training in Fraud and Forensic Accounting: A Guide for Educational Institutions, Stakeholder Organizations, Faculty and Students, Retrieved 07.06.2016. from https://www.ncjrs.gov/pdffiles1/nij/grants/217589.pdf.

PROSPECTS AND LIMITATIONS OF INCREASING LABOR PRODUCTIVITY IN THE RUSSIAN ECONOMY

Marina Borovskaya
Southern Federal University, Research Center "Instrumental, Mathematical and Intellectual Support of Economy", Russian Federation
bma@sfedu.ru

Marina Masych
Southern Federal University, Research Center "Instrumental, Mathematical and Intellectual Support of Economy", Russian Federation
mamasych@sfedu.ru

Marina Panichkina
Southern Federal University, Department of Economics, Institute of Management in Economic, Ecological and Social Systems, Russian Federation
panichkina@inbox.ru

ABSTRACT
Finding solutions aimed at increasing labor productivity, as the most important indicator of the social reproduction efficiency, remains to be a high nationwide priority and requires joint efforts of the government, scientific and business communities. This issue is particularly relevant to the Russian economy, considering all effects of an economic crisis and an aggravation of the geopolitical situation, as well as the ongoing globalization processes and arising challenges of the fourth industrial revolution. It shows that this issue is imperative for determining the country's future in terms of creating an independent and competitive economy. The methodology of the study is based on the systematic approach, methods of statistical and economic analysis of indicators of social and economic development of the Russian Federation, certain regions of the country and its industries. Application of the econometric model allowed to evaluate the relationships between labor productivity and particular factors that have influence on labor efficiency. The study includes the analysis of the modern trends related to the growth of labor productivity in economy of modern Russia; consideration of the existing potential of the Russian economy for increasing labor productivity and the role of internal constraining factors inhibiting the growth of labor efficiency; identification of the issues, related to the growth of high-performance workplaces, as one of the basic indicators of labor productivity of the Russian economy. Main provisions and conclusions of the article may be of interest to representatives of authorities, scientific and expert community, and also can be applied to research and teaching practices.
Keywords*: constraining factors, cross-sectoral differences, growth indicators, high-performance workplaces, labor efficiency, labor productivity*

1. INTRODUCTION

The increased topical character and the importance of the solution of problems of labor productivity for domestic economy is connected not only with its role of the major source of economic growth, means of weakening of inflationary expectations and overcomings the crisis phenomena that already in itself is urgent at a stage of post-crisis improvement, but also with definition of competitive positions of domestic economy in world economic system in strategically important directions of development. The modern civilization trend connected with transition of the world community to new fourth industrial revolution what it was declared at the World economic forum in Davos in 2016, defines need of coordination of

efforts of the state and business community on reindustrialization of domestic economy on the new technological basis assuming essential expansion of investments and the technological modernization of the industry relying on considerable activization of domestic researches and developments, on integration of production, science and education and expansion at this basis of training of qualified personnel. Besides, results of the analysis of world trends show high degree of an associativity of a gain in productivity of work to increase in level and quality of life [1] that is especially urgent in the light of problems of poverty of the working population of Russia [2].
Taking into account high rates of decrease in influence of the raw markets on world economy, stated turns questions of increase in labor productivity into a problem of the imperative importance and indicates the need of activization of its further scientific research.

2. THE ANALYSIS OF THE CURRENT TRENDS CONNECTED WITH WORK GAIN IN PRODUCTIVITY QUESTIONS IN MODERN ECONOMY OF RUSSIA

Modern features of the Russian economy are defined by existence of a number of the problems aggravating its unbalance and affecting the level of its efficiency and economic security of the country. So, as some of them, it is possible to note:
- considerable degree of dependence on the prices of raw material resources and from import of some types of production of strategic appointment;

- quite high share of raw export;

- deficiency of the working qualified force;

- reduction of employment in the processing productions, in agricultural industry and growth in trade, construction, in operations with the real estate;

- reduction of return from education against the background of growth of a share of highly educated workers;

- low competitiveness of a number of goods;

- existence of essential number of the carried-out non-core functions by the domestic industrial enterprises; not development of outsourcing;

- low level of introduction of highly effective personnel management systems in practice of domestic business, etc.

The associativity of the specified problems with labor productivity, is obvious.
The carried-out statistical analysis of labor productivity in the Russian Federation (tab. 1), shows decrease in indicators of its dynamics in 2010 - 2015 almost in all branches, and on economy, in general (tab. 1).
As the reasons of negative dynamics of an indicator, researchers note a combination of external and internal influences. It, and the general economic situation in the country, negative dynamics of the main macroeconomic indicators in 2015, and decrease in consumer demand, and consequently, and reduction of purchasing power of the population, reduction of investments into fixed capital, decrease in industrial production, underloading of production capacities, low interest of updating of technologies, etc.
From among the major factors exerting impact on labor productivity in Russia especially it is necessary to mark out technology factor which activization is connected with updating of fixed assets, increase in the volumes of investment into fixed capital, increase in costs of research and development, at the technological innovations exerting direct impact on economy of expenses and promoting increase in labor productivity and quality of production.

Table 1: Dynamics of an index of labor productivity on branches of economy of the Russian Federation, in % to previous year [3]

	2010	2011	2012	2013	2014	2015
In general on economy	103,2	103,8	103,5	101,8	100,7	97,8
including by types of economic activity:						
agricultural industry, hunting and forestry	88,3	115,1	100,4	106,5	103,3	104,9
fishery, fish breeding	97,0	103,5	108,5	103,8	96,1	99,5
mining	104,3	102,7	100,4	97,1	102,8	98,4
the processing productions	105,2	105,6	105,7	106,0	102,5	96,9
production and distribution energy, gas and water	103,0	99,8	101,3	99,5	100,2	99,9
construction	99,6	105,2	101,6	99,8	98,4	101,0
wholesale and home shopping service; repair and cars, motorcycles, household products and objects of private use	103,6	101,9	102,1	100,0	98,7	91,5
hotels and restaurants	101,7	102,3	101,5	101,0	99,8	94,1
transport and communication	103,2	105,4	102,2	102,7	100,4	99,4

The numerous modern monitoring researches devoted to a condition of domestic economy demonstrate that now it is characterized by extremely irrational age structure of the industrial equipment, the low level of investments into updating of fixed capital, insufficient rates of input of new fixed assets and leavings outdated, worn out (tab. 1).

Table 2: Dynamics of a condition of fixed assets of the Russian Federation [3]

Years	Degree of wear of fixed assets (on a cycle of the organizations; on the end of the year), %	Coefficient of updating of fixed assets (in the comparable prices), %	Coefficient of leaving of fixed assets	Rate of a gain of investments into fixed capital, %	Average age of cars and the equipment on all branches of economy, years
2010	47,1	3,7	0.8	-	22
2011	47,9	4,6	0,8	20,5	22
2012	47,7	4,8	0,7	14,05	20
2013	48,2	4,6	0.7	6,87	21
2014	49,4	4,3	0,8	3,4	18
2015	47,7	3,9	0,8	4,7	17
average value	48	4,1	3,02	8,25	20

Apparently from data of the table, degree of wear of fixed assets for 2015 made 47,7%, average value for the period – 48%; coefficients of leaving and updating of fixed assets are characterized by low values: on average 4,1% and 3,02% respectively; average age of the equipment - about 20 years. When ignoring of the developed indicators of wear of fixed capital, age of the equipment, low values of investments into fixed capital, it is not necessary to speak about approach to the international standards of domestic labor productivity.
On the basis of a research the following factors having significant effect on labor productivity are presented to authors key:
- volumes of investment into fixed capital,
- size of costs of research and development,
- size of costs of technological innovations.
In the choice authors recognize that productivity as efficiency of work depends on timely introduction of new perspective (breakthrough) technologies, updating of means of production which is provided with investments into fixed capital, and also is defined by the size of costs of scientific research, developments and technological innovations. For comparability of the specified factors to indicators of labor productivity it is expedient to use their specific values in terms of one occupied in economy.

3. FACTORIAL MODEL OF EXTENT OF INFLUENCE OF THE REVEALED FACTORS ON LABOUR PRODUCTIVITY ON THE BASIS OF PRODUCTION FUNCTION OF KOBBA-DUGLASA

For the purpose of definition of extent of influence of the specified factors on labor productivity we will construct factorial model on the basis of production function of Kobba-Douglas which in this case will look as follows:
$P = a_0 X_1^{a1} X_2^{a2} X_3^{a3}$, where:
P - labor productivity (GDP volume on one occupied);
X_1- internal costs of research and development in the actual prices of one busy;
X_2– of costs of technological innovations, in the actual prices of one busy;
X_3– investment into fixed capital,
a_0, a_1, a_2, a_3 – the parameters determined statistically.
In tab. 3. information on labor productivity size is provided in the Russian Federation and its major factors since 2005.

Table 3: Labor productivity and its major factors in the Russian Federation from 2005 for 2015 [3]

Years	GDP on one occupied	Internal costs of research and development in the actual prices, on 1 occupied	Costs of technological innovations, in the actual prices on 1 occupied	Investments into fixed capital on 1 busy
	P	X_1	X_2	X_3
2010	68613,04	775,45	594	135,6
2011	88253,4	902,4	1085	163,143
2012	98468,2	1030	1331	185,176
2013	104588,6	1104	1638	198,086
2014	114941,2	1250	1787	205,014
2015	118153,9	1337	1755	212,840

For a model experiment the Statistica program by means of which the following econometric dependence of labor productivity on the presented factors for the specified period is revealed was used:

$\ln P = 4,389 + 0,161 \ln X_1 + 0,183 \ln X_2 + 0,459 \ln X_3$.

The received econometric model allows to describe not only the general, joint influence of the studied factors, but also their individual influence on labor productivity.

Standard interpretation of the received parameters allows to draw a conclusion:

- at increase in specific internal costs of research and development by one percent at invariable values of other factors, the total value of labor productivity will increase on average by 0,161%;
- at increase in specific costs of technological innovations by one percent at invariable values of other factors, the total value of labor productivity will increase on average for 0,183%;
- at increase in specific investments into fixed capital by one percent at invariable values of other factors, the total value of labor productivity will increase on average for 0,459%.

Joint factorial influence at synchronous increase in each factor included in model for one percent will allow to increase labor productivity on average for 0,803%.

On the basis of the received equation the multiple coefficient of determination of R^2 which value made 0,868 is calculated. Therefore, the received equation of regression explains 86,8% of variations of values of labor productivity, i.e. is defined by the factors included in model.

For the purpose of confirmation of the statistical importance of the received equation of regression and multiple coefficient of determination the criterion of Fischer which value made is calculated: Fcalk = 34,922.

The received size considerably exceeds Fcritical = 3,239, corresponding to significance value a = 0,05 that confirms our hypothesis of influence of the studied factors on labor productivity with probability 0,95 and allows to recognize reliable the received econometric model.

For confirmation of the statistical importance of parameters of the received equation, calculation of criterion of Styyudent is carried out:

$t\ a_0\ calk.$ = 3,052
$ta_1\ calk.$ = 2,882
$ta_2\ calk.$ = 2,658
$ta_3\ calk.$ = 2,389
t critical = 2,120, at a = 0,05,

what also confirms reliability of the received econometric model allowing to describe not only the general, joint influence of the studied factors, but also their individual influence on labor productivity.

Also, the average error of approximation of empirical values of labor productivity production function which in this case makes 9,73% testifies to adequacy of model.

Calculation and further interpretation of the received values of private coefficients of determination:

$R^2_{lnX1} = 0,343$
$R^2_{lnX2} = 0,215$
$R^2_{lnX3} = 0,310$,

allows to claim that in the general dispersion the logarifmirovannykh of values of labor productivity:

- specific weight of internal costs of research and development makes 34,3%;
- specific weight of costs of technological innovations makes 21,5%;
- specific weight of investments into fixed capital makes 31,0%.

In connection with property of production function at which at equality of zero one of factors, obtaining result becomes impossible it is possible to draw a conclusion on coherence and interdependence, investigated in model of factors, i.e. technology factor of increase in labor productivity is interconnected with the investment potential of the Russian economy.

4. LABOUR PRODUCTIVITY AND PROVIDING WITH PERSONNEL RESOURCES

It should be noted that increase in labor productivity has to be in close connection and dependence on their providing with personnel resources, and provides the high level of investments into the human capital, its further evolution taking into account the new professions arising in the conditions of development of new technologies and new technological ways. Even taking into account a considerable share of import of technological and other types of innovations to domestic economy, the shots capable to adapt the specified loans to the Russian conditions that lifts the importance of a problem of preparation and retraining of the highly qualified personnel conforming to requirements of the dynamic hi-tech market are necessary and predetermines need of reorientation of domestic educational priorities [4, 5].

Current trends of an education system testify to insufficient development of competences of graduates of systems of secondary, higher and postgraduate professional education for adaptation to introduction of technological innovations that is one of the reasons of decrease in size of an indicator of a gain of high-performance jobs as one of important indicators of labor productivity of the Russian economy (tab. 4).

It is necessary to consider that preparation by systems of secondary, higher and postgraduate professional education of the shots answering to the level of high-performance jobs has to be based on the analysis of labor market in hi-tech sectors of economy and be defined by their real requirements since if in modern economy there is no demand for new technologies, then it will not be also on the corresponding competences. Besides, training for work with the latest information technologies, nanotechnologies, biotechnologies, etc. has to be carried out on the corresponding scientific and material and technological basis corresponding to world-class universities that confirms dependence of an innovation and investments and brings up the questions connected with modern financing of the educational organizations [6].

Now the gain of high-performance jobs in the Russian economy is characterized by the following data (tab. 4).

Table 4: Dynamics of a gain of high-performance jobs [3].

Years	thousands of units	%
2012	1849,1	12,7
2013	1122,8	6,9
2014	788,1	4,5
2015	-1671,9	-9,1
2016 (tentative data)	-802,1	-4,8

Thus, negative values of a gain of high-performance jobs in many respects are explained by lack of the shots capable to operate modern hi-tech means.

However, by comparison of indicators of a gain of high-performance jobs and an index of labor productivity (tab. 1) contradictory dynamics is visible.

It is also necessary to notice that according to the term "high-performance jobs" there is no uniform interpretation so far, and this term is often identified with highly paid jobs. Therefore, provided in tab. 4. data characterize a compensation problem in domestic economy rather and bring up a question of need of uniform approach to definition of the term and to the applied tools for carrying out analytical calculations and projections, taking into account high efficiency of the created jobs. The definition which is most answering to sense, in our opinion, following.

It "the economic workplace equipped with the modern hi-tech means of production providing high efficiency of the equipment, the organization of production on which allows to receive, when using labor of the corresponding qualification, labor productivity not below a certain level (for example, the level of developed countries of the world) at compensation adequate to it" [7].

5. LABOUR PRODUCTIVITY AND SALARY

The following factor significantly influencing labor productivity indicators is decrease in reproduction and motivational function of the salary and the income of the vast majority of workers of Russia [4, 9]. The mutually associativity of low indicators of compensation and productivity, insufficiency of the income for high-quality reproduction of labor and the solution of demographic problems, according to numerous researchers, is obvious specifics of national economy of Russia and influences the general level of its efficiency. [1, 2]. As the main reserve of pay rise in specific modern conditions, the forced stimulation of decrease in costs of production by its innovatization is considered.

World tendencies of change of size of the salary are connected with such factors as GDP growth, inflation. Recently worldwide lag of growth rates of the salary from growth rates of labor productivity is noted, reduction of a share of compensation in GDP of these countries turned out to be consequence of what. "The combination of factors, including globalization, change of requirements to qualification owing to technical progress, weakening of institutes of labor market, and also the growing pressure from the financial markets forcing to share profit on activity of large corporations in favor of investors" [2] is specified as the main reasons.

It should be noted that representation of many politicians and analysts of the Russian economy of rather steady advancing of growth rates of the real wage in comparison with growth rates of labor productivity in the country, is called into question by R. I. Kapelyushnikov, S. S. Sulakshin, V. E. Bagdasaryan, I. Yu. Kolesnik's works, etc., and is confirmed by their calculations about changes of a share of compensation in GDP, generally, for the Russian economy, and, in gross value added (GVA), for the industry (tab. 5).

Table 5: Compensation shares for the Russian economy generally, and for the industry, % [8].

Years	General share of compensation in GDP in market prices	General share of compensation in industry GVA
2010	49,6	38,8
2011	49,6	37,5
2012	50,6	37,8
2013	51,8	39,0
2014	47,5	37,8
2015	47,8	36,2

Apparently from the submitted data (tab. 1, tab. 5) for the Russian economy generally cumulative prirosta of labor productivity and compensation for the period practically coincide. In relation to the industry, it is possible to speak about reduction of real specific labor expenses in VDS that indicates considerable rates of their decrease concerning rates of labor productivity [8].

Let's carry out the correlation analysis [9], for an assessment of communication of the salary and labor productivity, in various branches of economy (calculations are carried out on the basis of data of official statistics [3]).

Table 6: The calculated correlation coefficients on branches of economy [3]

Branch	Correlation coefficient
Agricultural industry, hunting and forestry	-0,36871
Fishery and fish breeding	0,369953
Mining	-0,26256
The processing productions	-0,29612
Production and distribution of the electric power, gas and water	-0,63606
Construction	-0,63931
Wholesale and home shopping service	-0,67538
Hotels and restaurants	-0,71864
Transport and communication	-0,38609
Operations with a fast estate	-0,72833

On the basis of the correlation and regression analysis we can tell that feedback between labor productivity and the salary since correlation coefficients negative except for branch "Fishery and fish breeding", the positive coefficient of a variation allows us to tell that communication between the salary and productivity the straight line and has moderate character, according to Cheddok's scale is revealed. The received dependences can be explained with the fact that in the real conditions the salary as remuneration for work practically lost the stimulating and reproduction functions. Thus, the additional analysis of possible factors and reserves of a gain in productivity of work is necessary. Productive use of such factors directly positively influences the balanced economic development of the territory and its economic growth.

6. CONSLUSION

Increase in labor productivity - one of the objective economic laws inherent in each socioeconomic structure. This law is expressed that thanks to development of productive forces society reduces socially necessary costs of work of production of various products intended for personal or public consumption. In process of accumulation by people of experience, knowledge, disclosure of laws of the nature, mastering of their use consecutive increase in labor productivity happens them and.

The essence of the law of increase in labor productivity consists in creation of a maximum of a product at a work minimum and therefore increase in public labor productivity objectively promotes progress of mankind that is expressed in growth of production of goods, in development of science, culture, art, all parties of a civilization. Each next way of production wins previous, eventually, thanks to the fact that it provides a bigger scope for development of productive forces of society, for growth of public labor productivity.

On the basis of the conducted research the following key factors having significant effect on labor productivity are revealed: volumes of investment into fixed capital; size of costs of research and development; size of costs of technological innovations. As labor productivity depends on timely introduction of new breakthrough technologies, updating of fixed assets which is provided with investments into fixed capital, and also is defined by the size of costs of scientific research, developments and technological innovations.

In the course of the research the factorial model of extent of influence of the revealed factors on labor productivity on the basis of production function of Kobba-Douglas is constructed. Results of modeling allow to draw a conclusion that the greatest impact on change of labor productivity is exerted by change of specific investments into fixed capital (at increase in

specific investments into fixed capital by one percent at invariable values of other factors, the total value of labor productivity will increase on average for 0,459%).

In the analysis of interrelation of labor productivity and providing with personnel resources it was revealed that now the education system not fully provides graduates with necessary ompetention for adaptation to introduction of technological innovations that is one of the reasons of decrease in size of an indicator of a gain of high-performance jobs as one of important indicators of labor productivity of the Russian economy.

The following the analysed factor – the salary and its influence on labor productivity. Decrease in reproduction and motivational function of the salary and the income of the vast majority of workers of Russia is observed. Noted phenomena demonstrate, in our opinion, that the person of work practically dropped out of the field not only labor, but also social policy of the state. Work as value remains in modern conditions extremely devaluated, and the person of work – socially and economically unprotected. Essentially new system of social, economic and legal interaction between the state, employers and workers also is necessary for creation of conditions, necessary for highly effective and productive work, in essentially new market environment.

LITERATURE:

1. Krivov of EL (2016) *Labour productivity in Russia and in the world. Influence on competitiveness of economy and level of living.* Analitical bulletin No. 29 (628). Retrieved 10.05.2017 from http://www.council.gov.ru/activity/analytics/analytical_bulletins/71413/.

2. The salary in the world in 2016-2017 inequality in compensation at the enterprises. Retrieved 10.05.2017 from http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_544096.pdf.

3. Official statistics. Retrieved 10.05.2017 from http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/efficiency/#/

4. Panichkina M. V., Burova I. V. (2015) *Transformation of economic behavior of domestic higher education institutions in the conditions of demographic recession.* The Crimean scientific bulletin. 2015. No. 5. Volume 1. Pp. 133-142.

5. Zadorozhny E.K., Masych M.A., Panichkin M.V. (2009) *Problems of training of competitive specialists.* News of SFU. 2009. No. 3. Pp. 93-103.

6. Masych M.A., Panichkin M.V. (2016) *Instruments of increase in effectiveness of activity of teachers of higher education institution: material aspect.* Public and municipal administration. Scientific notes of SKAGS. 2016. No. 3. Pp. 169-176.

7. Kuznetsov S.G., Korovkin A.G. *High-performance jobs: definition, account, analysis and forecasting.* Retrieved 05.05.2017 from http://cyberleninka.ru/article/n/vysokoproizvoditelnye-rabochie-mesta-opredelenie-uchet-analiz-i-prognozirovanie.

8. Russian labor market: tendencies, institutes, structural changes: report of Higher School of Economics National Research University. Moscow, 2017.

9. Masych M.A., Kapluyk E.V. (2014) *The analysis of indicators influence of fixed assets updating and salary on labour productivity growth.* Economy and management of innovative technologies. 2014. No.11 Retrieved 05.05.2017 from http://ekonomika.snauka.ru/2014/11/6428

ENERGY EFFICIENCY IN THE SERVICE SECTOR

Ivan Vojteski
Faculty of Mining and Geology, University of Belgrade,
ivnaftagas@gmail.com

Maja Cogoljevic
Faculty of Business Economics and Entrepreneurship, Belgrade
maja.cogoljevic@vspep.edu.rs

ABSTRACT

The emphasis of this paper is on the specifics of energy efficiency impact on the servicesector profitability. Illustrations of the theoretical and methodological presentations are based upon the comparison of the original empirical data of the European Union (EU) and Serbia. Data from the surveys conducted in the United States of America, Canada and Russia were used to further support the analysis. The results of empirical research show that energy efficiency in the service sector in Serbia is considerably lower than in the European Union and other countries with developed market economy. Therefore, it is necessary to introduce appropriate measures to improve energy efficiency of the service sector in Serbia in the future.

These are: modern energy technologies, increase of renewable energy share in total final energy consumption, reduction of energy consumption throughout the supply chain, reduction of carbon dioxide emissions related to the energy consumption, construction of energy efficient office buildings and retail facilities, and improvement of the existing. The objective of such measures is to improve profitability in the service sector in Serbia.

Keywords:*energy intensity, renewable energy sources, energy management, green energy, final energy consumption*

1. INTRODUCTION

In recent years considerable attention is paid to the impact of energy efficiency on the profitability of all companies, including service. That is understandable when one bears in mind that energy savings, reduction of water consumption, reduction of emissions carbon dioxide with respect to power consumption, and waste treatment are major problems on the global level. Great attention is paid to improvements of environmental protection in the context of sustainable development, and final energy consumption. Therefore, we focus on specifics of the impact of energy efficiency on the service sector performance, from the standpoint of sustainable development. Original empirical data of selected countries of the EU and Serbia, as well as the United States, Canada and Russia has been used to support this theoretical and methodological research. There is a growing body of literature on energy efficiency analysis in recent years. That is understandable when one takes into account that energy efficiency is a key factor in companies' profitability. Nevertheless, literature dedicated primarily to the issues of energy efficiency in the service sector is not extensive. Therefore, our research seeks to draw attention to most significant aspects of managing energy in the service sector. Our theoretical and methodological presentations are illustrated with original empirical data from different countries, especially the EU and Serbia. The research conducted in this and other studies show that the efficient management of energy can significantly reduce costs (total costs and energy costs), and thus increase profits in the service sector. The paper presented hypothesis that efficient energy management significantly affects the improvement of the companies' profitability, including service and trading. Consequently, it is suggested that centres for energy management should be organized in all service companies. These centers would deal not only with the problems of energy efficiency,

but also with the reduction of water consumption, and carbon dioxide emissions related to the consumption of energy. Special reports on energy efficiency should be prepared as an integral part of the total annual reports of the service sector entreprises. The research methodology of the presented study is based upon theory, norm and, in particular, comparative analysis of empirical data (indicators) of service sector energy efficiency. Within the applied research methodologies, indicators of energy intensity are very important, and to some extent specific to the service sector. The empirical data were collected from different sources: literature, EuroStat, annual reports and other relevant statistics. The limitation of this study is that empirical data on service sector energy efficiency in selected countries are not fully comparable due to the unequal application of the methodology of production and the relevant regulatory frameworks. Nevertheless, it does not significantly diminish the importance of insights gained from such comparison. It should provide an insight into the characteristics and trends of energy efficiency in the service sector at the global level and in Serbia. On this basis, we propose measures aimed to improve energy efficiency as a key factor in the service companies' profitability.

2. MANAGING ENERGY IN THE CONTEXT OF SUSTAINABLE DEVELOPMENT

Considerable attention of the service sector is lately directed to improvement of energy efficiency management in the framework of sustainable development (Lukic, 2014d; Christina, 2015), and the emission of carbon-dioxide in the context of energy consumption. Energy management is increasingly treated as a separate centre of responsibility in all enterprises, including service (Lukic, 2011, 2012, 2013a, b; 2014 a, b, c, d; 2015a, b, c, d; Vojteski Kljenak, 2015).Figure 1 presents three aspects of energy efficiency and energy management in the context of sustainable development. In the context of sustainable development in the service sector, so-called "Green energy" significantly affects energy efficiency improvement, as shown in Figure 2.The commercial sector participation in total final energy consumption is significant. It can be derived from the data on energy consumption in individual economic sectors in California in 2011: commercial 42%, agriculture 7%, residential buildings 33%, street lighting 1%, industry 14%, mining and construction 3%.(Energy Research and Development Division Final Project Report: *Saving Energy in Buildings with retail Adaptive Envelope Systems*, April 2015, CEC - 500-2015 - XXX, California Lighting Technology Centre, UC Davis, Energy Commission, State of California;
http://cltc.ucdavis.edu/sites/default/files/files/publication/201504-retail-buildings-adaptive-envelope.pdf (accessed May 10, 2017) Commercial sector's share in carbon dioxide emissions with greenhouse effect is also significant. Fro example, it reached 10% in the United Kingdom in 2013.(Building Efficiency: Reducing energy demand in the commercial sector, 2013 A report by the Westminster Sustainable Business Forum and Carbon Connect; http://www.policyconnect.org.uk/wsbf/sites/site_wsbf/files/report/403/fieldreportdownload/wsbfreport-buildingefficiencypdf.pdf) (accessed May 10, 2017)

3. ENERGY EFFICIENCY IN THE SERVICES SECTOR OF THE EUROPEAN UNION

In the recent years the EU devotes significant attention to the development and application of the sustainable development concept. Numerous studies direct attention to the energy efficiency analysis. The goal of sustainable growth in the EU for 2020 is 20% reduction of gas emissions which produce the greenhouse effect, when compared to 1990; increased participation of renewable energy consumption up to 20%; and increased energy efficiency by 20%.(Eurostat: Sustainable development in the European Union - 2015 monitoring report of the EU Sustainable Development Strategy).In addition, a global strategy and policy of efficient use of available energy resources was defined.

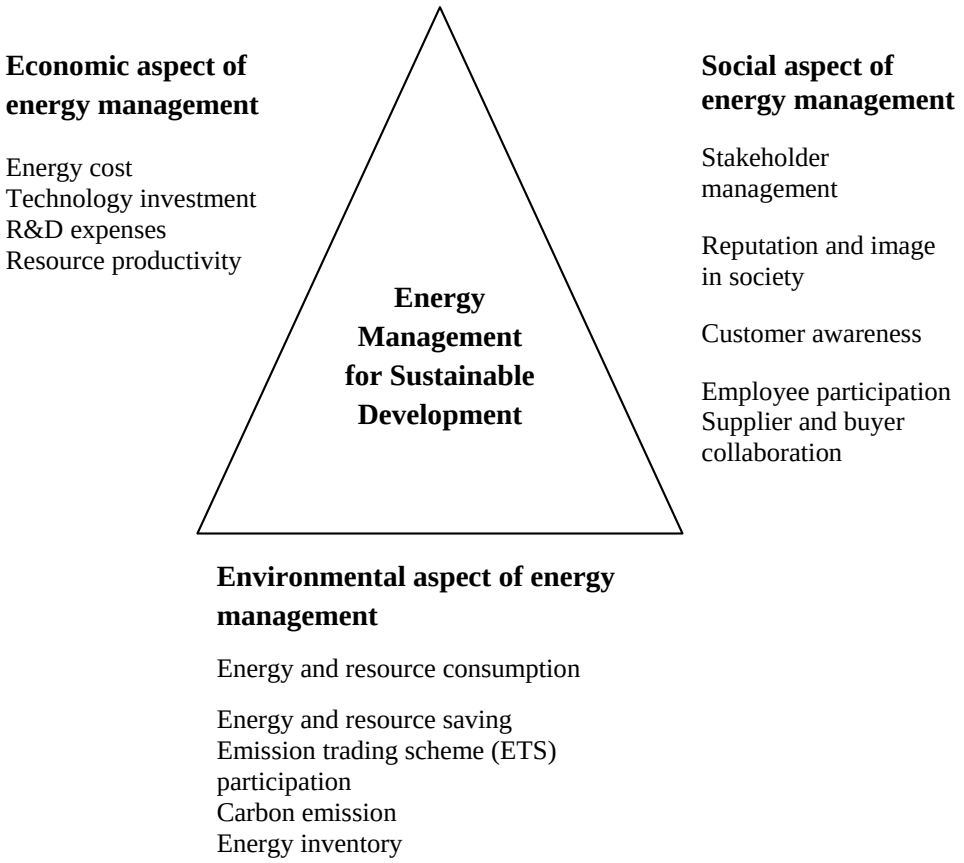


Figure 1. Energy management in sustainable development
Source: Lee, (2015)

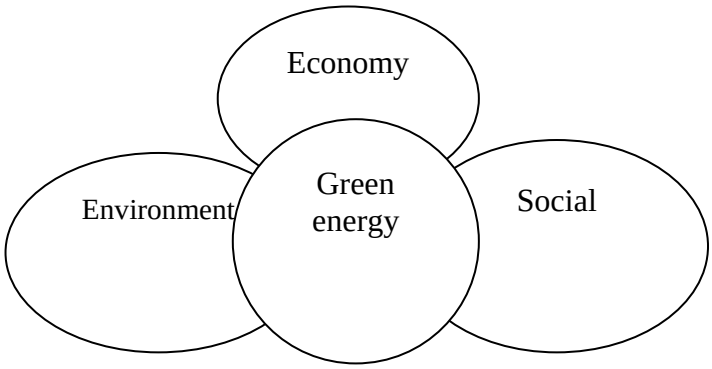


Figure 2. Green Energy in sustainable development
Source: The Profitable Shift to Green Energy, 2012, AT Kearney; www.atkearney.de /.../ the-profitable-shift-to-green...)

The final energy consumption differs among sectors. Table 1 is an illustration which shows final energy consumption by sector (in % of the total) in the EU-28 for 1990 and 2013.

Sector	1990	2013
Industry	34,1	25,1
Transportation	26,3	31,6
Residential buildings	25,4	26,8
Agriculture/Forestry	2,9	2,2
Services	10,1	13,8
Other	1,2	0,5

Table 1.Final energy consumption by sector (in % of the total) in the EU-28, 1990 and 2013. Source: Eurostat: Sustainable development in the EU - 2015 monitoring report of the EU Sustainable Development Strategy.

According to the data presented, service sector participates with over 10% in the structure of the EU's final energy consumption. It can be significantly reduced by application of new energy technologies and the use of solar energy. This will certainly have a positive impact on increasing the profitability of the service sector in the EU.Under the concept of sustainable development in the EU, significant attention is paid to the reduction of carbon dioxide emissions by applying an effective climate policy, structural changes and elimination of certain so-called "polluting" economic activities. Table 2 shows carbon dioxide emissions by sector in the EU for 1990 and 2012.

Sector	1990	2012
Energy, including transportation	62,1	57,9
Transportation, including international aviation	15,0	21,9
Agriculture	10,8	10,0
Industrial process	8,1	6,8
Waste	3,7	3,0
Solvents and other products	0,3	0,2

Table 2:Carbon dioxide emissions by sector (in % of the total) in the EU-28, 1990 and 2012 Source: Eurostat: Sustainable development in the EU - 2015 monitoring report of the EU Sustainable Development Strategy.

Therefore, energy and transportation sectors are major producers of carbon dioxide and environment polluters in the EU.In the context of the EU's environmental protection, considerable attention is paid to the treatment of waste as economic activity by-product. Waste generators on the basis of economic activity (in % of total) in the EU-28 in 2012 were: manufacturing 25.5%, water supply, sewerage, waste management and water activities 20.5%, construction 16.0%, mines and quarries 15.5%, services (except wholesale waste) 11.0%, electricity, gas, steam and air-conditioning supply 8.0%, households 3.5%, agriculture, forestry and fishing, 1.0%, and wholesale

waste 1%. (Eurostat: Sustainable development in the EU - 2015 monitoring report of the EU Sustainable Development Strategy).Therefore, the service sector participation in generating waste is significant in the EU. Including wholesale, it participates with 12%.

4. ENERGY EFFICIENCY IN THE SERVICES SECTOR IN SERBIA

The total primary energy production in Serbia in 2013 was 789.7Mtoe. In terms of energy sources, the breakdown is as follows: solid fuels 67.4%, oil 10.8%, gas 3.7%, nuclear energy 0.0%, renewable sources 18.1% and waste (non-renewable) 0, 0%. It is noticeable that Serbia has significantly lower share of renewable energy in total primary energy production in relation to all EU (except the Netherlands and the United Kingdom in 2013) and neighboring countries, with an expected tendency of its increase in the future (Eurostat - Energy production and imports). It will definitely have a positive impact on increasing energy efficiency in all economy sectors, including service. Considerable attention is paid to improving energy efficiency in all economic sectors In Serbia over the last years. Table 3 shows comparative final energy consumption by sector in selected countries in the EU and Serbia in 2013.

	Final energy consumption – total	Industry	Transportation	Residential buildings	Agriculture / Forestry	Services	Other
EU (28 countries)	1,103,813,3	276,637,6 25,1%	348,548,1 31,6%	295,876,5 26,8%	23,898,2 2,2%	152,541,3 13,8%	5,177,5 0,5%
Germany	217,251,4	60,736,6 27,6%	62,621,1 28,6%	59,697,9 27,2%	0 0%	34,049 15,7%	145,8 0,1%
France	152,056,5	30,025,3 19,7%	49,263 32,2%	43,678,9 28,3%	4,318,9 2,6%	22,997,3 14,5%	1,472,8 0,6%
Croatia	5,812,5	1,116,2 19,9%	2,037,9 34,9%	1,719,3 29,6%	197,5 3,3%	712 12,2%	0 0%
Slovenia	4,798,3	1,196,4 24,9%	1,865,4 38,9%	1,156,6 24,1%	74,7 1,5%	486,5 10,1%	18,7 0,4%
United Kingdom	136,432,4	25,709,9 18,4%	50,476,5 36,7%	40,208,3 29,4%	872,8 0,6%	17,667,3 12,5%	1,497,6 1,1%
Serbia 2013 - % 1990 - %	8,314,5	2,477,4 29,8% 38,9%	2,004,7 24,1% 14,1%	2,869,8 34,5% 24,8%	182,9 2,2% 0,6%	779,8 9,3% 0,5%	0 0% 21,1%

Table 3. Final energy consumption by sector in selected countries in the EU and Serbia in 2013 (1,000 tons of oil equivalent)
Note: Calculation of the percentage structure for Serbia performed by the Author
Source: Eurostat - Final energy consumption by sector

The share of services sector in total final energy consumption in Serbia is considerably lower than in the EU, Germany and France. It is also much lower in relation to comparable countries of the region - Croatia and Slovenia. In 2013, it amounted to 9,3% and only 0.5% in 1990. Therefore, the service sector final energy consumption in Serbia increased, as can be seen from Figure 3

Figure following on the next page

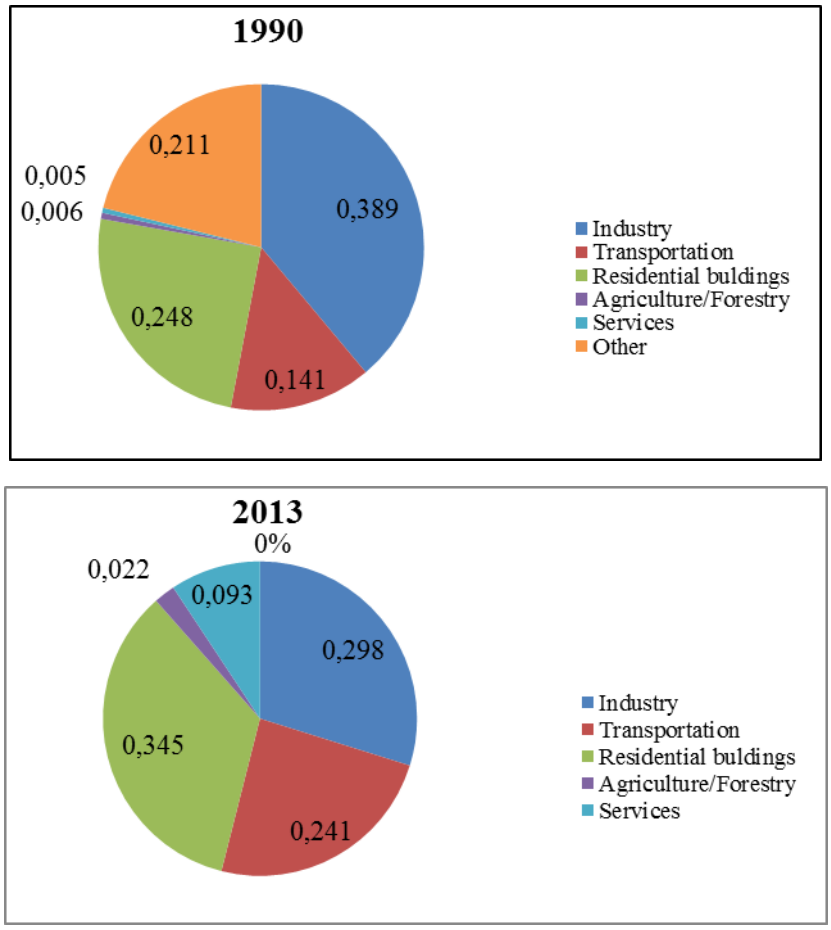


Figure 3.Final energy consumption by sector in Serbia in 1990 and 2013.
Note. Figure produced by the Author
Source: Eurostat - Final energy consumption by sector

In order to acquire the best perspective on the movement of final energy consumption in the service sector in Serbia, Figure 4shows data for the period 1990 - 2013.

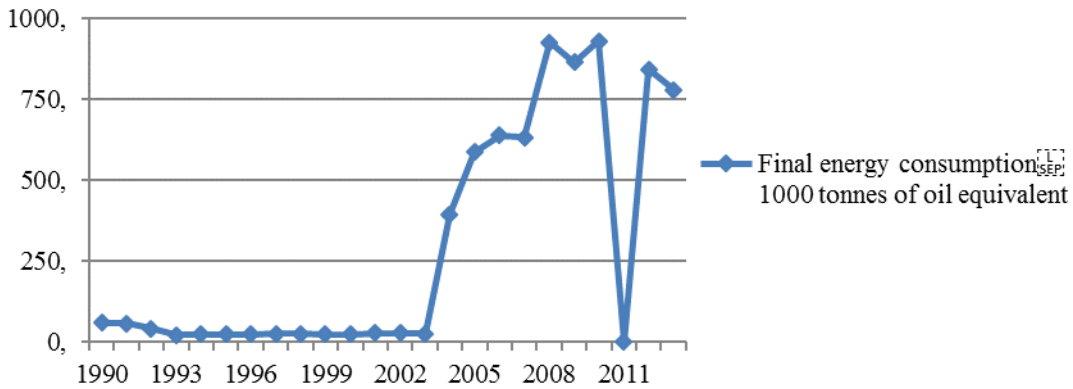


Figure 4. Final energy consumption in the service sector in Serbia 1990 – 2013.
Source: Eurostat - Final energy consumption by sector

Data in the table shows that during the observed period, final energy consumption in the service sector in Serbia significantly increased in recent years. It is evident from Figure 4. The increase in the service sector energy consumption in Serbia is causing an increase in energy costs and reduction in profits (at equivalent income). Therefore, it is necessary to apply relevant measures, above all sustainable development (green energy) to improve energy management of the service sector in Serbia so as to increase its profitability in the future. In addition to the quantitative component (kWh), price also affects energy expenses. The price of energy (electricity and natural gas) differs among countries. This is indicated by the data in Table 4.

Country	Electricity price (kWh/euro)	Gas prices (kWh/euro)
EU-28	0,120	0,037
Germany	0,152	0,040
France	0,091	0,038
Croatia	0,092	0,040
Slovenia	0,085	0,044
United Kingdom	0,134	0,035
Serbia	0,067	0,038

Table 4. Industrial consumers energy costs in selected countries of the European Union, 2014. Note: Kilowatt hour - kWh
Source: Eurostat - Electricity and natural gas price statistics

The price of electric power in Serbia is lower in relation to the (average) of the European Union and each of its observed members. The price of natural gas is slightly higher than the average of the EU, France and the United Kingdom, but is lower compared to other observed countries. Such movement of energy prices for industrial consumers in Serbia is the result of a very low economic activity (i.e. high rates of the economy underdevelopment compared to developed market economies, such as Germany, France and the United Kingdom, and many others in transition).In Serbia, as in other countries, there is a developed action plan for energy efficiency. as shown in Table 5.

Table following on the next page

The period of energy efficiency action plan coverage from 2010 – 2018 Global goal of energy savings – Directive 2006/32/EC (kiloton of oil equivalent - ktoe / % / year) 752 /9 / 2018 Second energy efficiency action plan accepted and published on 21. October 2013 Achieved energy savings 2010 – 2012 102ktoe (1.22%) Key institutions involved Ministry of mining and energy, Ministry ???				
Indicators of energy efficiency	2009	2010	2011	2012
Total primary energy offer ktoe	15,177	15,536	16,185	14,463
Energy intensity (Total primary energy offer / Gross domestic product) toe / 1,000 USD	0,55	0,56	0,57	0,52
Total primary energy offer/ Population toe/resident	2,07	2,13	2,23	2,00
Total final energy offer ktoe	8,786	9,479	9,778	8,622
Total final energy consumption per sector %				
Residential buildings	35%	33%	32%	36%
Services	8%	7%	8%	10%
Industry	23%	25%	28%	28%
Transport	25%	23%	20%	20%
Other	3%	4%	4%	2%
Non energy use	7%	8%	8%	4%

Table 5. Energy Efficiency Action Plan in Serbia
Note: Thousand tons of oil equivalent - ktoe; ton of oil equivalent - toe
Source: Energy Community - Annual Implementation Report 2013/2014, the Energy Community Secretariat, 1 August 2014.

Shown data illustrate that the realized energy savings in Serbia were 1.22% for the period 2010 - 2012. It was expected to reach 4,7% in 2015, and further increase in the following years. The energy efficiency is to be improved by use of modern energy technologies, increase of renewable energy sources in total final energy consumption (in 2020 by 27% compared to 21.2% in 2009), construction of energy-efficient office buildings, and improving conditions of the existing, so called “green buildings". (Energy Community - Annual Implementation Report 2013/2014, the Energy Community Secretariat, 1 August 2014.)These measures will have a positive impact on energy efficiency in all economic sectors, including service in which there are great opportunities for business under the principles of "green economy”, especially in the trade sector as its very important integral part.Energy intensity indicator is used to measure energy efficiency. Energy intensity indicates how much (primary

and secondary) energy is consumed per unit of the gross domestic product per capita of a country or area. Smaller energy intensity means better use of energy and vice versa (Gvozdenac, et al., 2012, 2014). Table 7 shows indicators of energy efficiency and carbon dioxide emissions in the service sector for selected countries of the European Union and Serbia in 2013.

Country	Energy intensity (in terms of added value) (at purchasing power parity), unit koe/$05p	Electrical intensity (in terms of added value) (at purchasing power parity), unit kWh/k$05p	CO_2 intensity (in terms of added value) (at purchasing power parity), unit kCO_2/05p
European Union	0,016	89,5	0,018
Germany	0,018	77,4	0,026
France	0,016	98,9	0,017
United Kingdom	0,012	65,4	0,014
Croatia	0,018	133	0,013
Slovenia	0,015	114	0,011
Serbia	0,020	126	n.a

Table 6. Indicators of energy efficiency and carbon dioxide emissions in the service sector of selected countries in the EU and Serbia in 2013.
Note: Purchase power parity - ppp. Kilograms of oil equivalents – koe
Source: Economic Commission for Europe. Committee on Sustainable Energy.Initial review of energy efficiency in the ECE region. Discussion Paper No.1, ECE / Energy / GE.6 / 2014 / Inf.1

The table illustrates that the service sector energy intensity in Serbia is significantly higher (lower energy utilization) in comparison to EU and regional countries. In 2013 it (0.020 koe / $05p) increased by 0.8% compared to 2000 (0,018 koe / $05p).(Economic Commission for Europe. Committee on Sustainable Energy. Initial review of energy efficiency in the ECE region. Discussion Paper No.1, ECE / Energy / GE.6 / 2014 / Inf.1Therefore, it is necessary to adopt appropriate measures so as to improve energy efficiency (reduction of energy intensity) in Serbia's service sector in the future. Table 7 provides deeper insight into the issue, showing dynamics of energy efficiency and carbon dioxide emissions in Serbia's services sector for the period 1990 - 2013.

Table following on the next page

	Unit	1990	2000	2005	2009	2010	2011	2012	2013	1990/13 (%/year	2000/13 (%/year
Energy intensity (in terms of added value) (at purchasing power parity) – ppp)	Koe/$06p	n.a.	0,018	0,019	0,024	0,025	0,028	0,022	0,020	n.a.	0,8
Electrical intensity (in terms of added value) (at purchasing power parity) – ppp)	kWh/k$05p	n.a.	178	160	134	134	133	131	126	n.a.	-2,6
CO_2 intensity (in terms of added value) (at purchasing power parity) – ppp)	kCO_2	n.a.	0,010	0,011	0,031	0,037	0,050	0,028	n.a.	n.a	n.a

Table 7.Dynamics of energy efficiency and emissions of carbon dioxide in the service sector in Serbia 1990 - 2013.
Source: Economic Commission for Europe. Committee on Sustainable Energy. Initial review of energy efficiency in the ECE region. Discus866920sion Paper No.1, ECE / Energy / GE.6 / 2014 / Inf.1

The table shows annual increase in Serbia's service sector energy intensity for the period 1990 – 2013.In other words, the use of energy was not at the satisfactory level. In the context of sustainable development appropriate measures should be taken to improve energy efficiency. In the reporting period, the service sector electrical intensity in Serbia decreased on an annual basis, which means that electrical efficiency improved gradually. This growing trend should be continued in the future. In the service sector in Serbia, carbon dioxide emission increased annually during observed time period. Considering this, effective ecological measures should be implemented in the future in order to reduce its emission.

5. CONSLUSION

Energy efficiency has recently become a major factor of profitability in all sectors of the economy, including the service sector. Given that, many theoretical, methodological and empirical approaches are being continually explored to improve it. There are significant opportunities to improve energy efficiency in all sectors of the economy so as to improve

their profitability. The research of the service sector of the EU and Serbia in this paper has shown that energy efficiency is much higher in the EU than in Serbia.
Therefore, it is necessary to take all relevant measures in Serbia within the sustainable development framework so as to improve energy efficiency in the service sector. Primarily, these include: use of modern energy efficient technology, renewable energy sources, improving energy efficiency of office buildings and stores, the reduction of carbon dioxide emissions related to energy, defining the purpose and plan adequate power management strategies, business based on the principle of "green economy", and others.

LITERATURE:

1. Allcott, H. and Sweeney, R. (2014). Can Retailers Inform Consumers about Energy Costs? Evidence from a Field Experiment. *Working paper*, New York University, 1-52.
2. Blake, N., Holberton, R. and Pearce, R. (2015), *Sustainable Shopping Centres: Energy, Performance and Value*, BCSC (British Council of Shopping Centres), London.
3. Christina, S. et al., (2015).A socio-technical approach to improving retail energy efficiency behaviours.*Applied Ergonomics*, 47, 324-335.
4. Dangana, Z., Pan, W. and Goodhew, S. (2012). Delivering sustainable buildings in retail construction, in: Smith, S.D. (Ed) *Procs 28th Annual ARCOM Conference*, 3-5 September 2012, Edinburgh, UK, Association of Researchers in Construction Management, 1455-1465.
5. Dong, B., Gorbounov, M., Yuan, S., Wu, T., Srivastav, A., Bailey, T. and O'Neill, Z. (2013).Integrated energy performance modelling for a retail store building.*Building Simulation*, 6(3), 283-295.
6. Eurostat: Sustainable development in the European Union – 2015 monitoring report of the EU Sustainable Development Strategy.
7. Gvozdenac, D. D. et al. (2014). Serbian Energy Efficiency Problems.*Thermal Science*, 18(3), 683-694.
8. Gvozdenac, D.D. et al. (2012). About the Serbia Energy Efficiency Problems.*Thermal Science*, 16(1), S1-S15.

CONSUMER PROTECTION IN GAMES OF CHANCE

Ivana Kanceljak
Faculty of Law, University of Zagreb (Chair of Civil Law)
ivana.kanceljak@pravo.hr

ABSTRACT

Players who participate in games of chance may, by concluding these contracts, be faced with a problem of an over-indebtedness. Because of that, players who participate in games of chance are in this paper considered as consumers. Because of that it is explored whether they are protected by usual consumer protection rights and are there consumer right which can be considered also a good way to prevent over-indebtedness. The main thesis is that consumers who are concluding gaming contracts, are not protected in an adequate way. This research first discusses the main characteristic of aleatory contracts and gaming contract. It has shown that the particularities of the contracts which they conclude do not enable the implementation of the usual consumer protection mechanisms. On the other hand, there are some legal solution in Consumer Protection Act and Games of chance Act that aim to provide protection of consumer which are concluding gaming contracts. Since at European Union level this problem is particularly acute in the sphere of on-line gambling, Recommendation 2014/478/EU on principles for the protection of consumers and players of online gambling services and for the prevention of minors from gambling online was adopted. Key objectives of the mentioned Recommendation are presented and elaborated.
Keywords*: consumer protection, games of chance, over-indebtedness*

1. INTRODUCTION

It has already been paid particular attention to the games of chance, which is manifested in an interdisciplinary approach to researching and especially through a problem of gambling addiction. Research of the legal aspects was also present. Games of chance are contracts that can be classified as aleatory contracts. Person concluding these contracts can be considered also as the consumer.[1] From one point of view, games of chance can be the cause of the over-indebtedness of the consumers, while, on the other hand, during the financial crisis it can be considered as an easy way to make money.[2] That can be a wrong motive for conclusion of the contract, which can be considered as one of the reasons why it is essential to have an appropriate protection of the consumers who conclude such contracts.

Until now the policy of protection of the consumers of the European Union was not focussed on providing the protection through directive to the consumers who participate in games of chance. It could even be said that the mentioned type of protection was willingly avoided. This is evident from the introduction of 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[3], as well as it is evident from article 3 paragraph 3, according to which it

[1] See more on that in this article: 2.2. Specific characteristics of the games of chance.

[2] About gambling and over-indebtedness see more: Barron, J. M., Staten, M. E. and Wilshusen S. M. (2002). *The impact on casino gambling on personal bankruptcy filing rates*; Contemporary Economic Policy, vol. 20., issue 4, p. 440-455.

[3] OJ L 304, November 22, 2011, pp. 64–88, hereinafter referred to as: Directive 2011/83/EU. In Croatian legal system this directive is implemented in the Consumer Protection Act (hereinafter referred to as: CPA), Official Gazette 41/14, 110/15.

is prescribed that the mentioned Directive shall not apply to "contracts for gambling, which involves wagering a stake with pecuniary value in games of chance, including lotteries, casino games and betting transactions." Similar approach regarding the exclusion of the application of the provisions of the directive on the gaming contracts is evident in 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)[4], as well as it is evident in Directive 2006/123/EU of the European Parliament and of the Council of 12 December 2006 on services in the internal market[5].

In this paper it is considered that there is no protection of the consumers – players who participate in games of chance – through directives, because these contracts are not the contracts regarding which the protection of the consumers could be achieved by the realisation of the common consumer rights.[6] Precisely because of that, it is necessary to determine whether the consumers are protected or not and if they are protected, then it is necessary to determine to what extent they are protected, and if it is possible to prevent the over-indebtedness of the players by using the existing measures. Therefore, the first part of this paper shall focus on the determination of the term games of chance and on emphasising of their characteristics in order to establish whether the previously mentioned argument is correct or not. The second part of the paper shall focus on the overview of the proposed protection of the consumers who conclude the gaming contracts via the internet.

2. GAMES OF CHANCE – TERM AND CHARACTERISTICS

2.1. Definition of the term games of chance

Aleatory contract (*pacta aleatoria*) is a special type of contracts. Games of chance can be classified as aleatory contracts. Obligations Act does not contain a general definition of the aleatory contracts, but the legal literature defines them as "legal transactions regarding which at the moment of their conclusion the rights and obligations of the contractual parties are not entirely known, sometimes even the position of the contractual parties is unknown, but it is conditional upon some external, uncertain event".[7] Apart from the definition, in the Obligations Act it is not exhaustively listed which legal transactions are aleatory contracts, but it could be said that, apart from games of chance, aleatory contracts are the lifelong support contracts and the contracts for support until death and as well insurance contract. [8][9]

This paper is focusing on the games of chance which are regulated by the Games of Chance Act[10] (hereinafter referred to as: GCA). First, the GCA provides us with a general definition of the games of chance, defining them as: "games in which for the payment of a certain consideration it is enabled for the participants to realize a reward in money, things, services or rights, the outcome of which depends predominantly on chance or on some other uncertain

[4] OJ L 178, July 17, 2000, pp. 1-16. The mentioned directive is implemented in the Electronic Commerce Act, Official Gazette 173/03, 67/08. 36/09, 130/11, 30/14. See in article 1 paragraph 1.

[5] OJ L 376, December 27, 2006, pp. 36-68. See article 2 paragraph 2. The Republic of Croatia has fulfilled the obligation of implementation of directive on services in the internal market by adopting the Act on Services, Official Gazette 80/11.

[6] See the result of research in this article under: 2.3. Games of chance and consumer protection.

[7] As presented: Klarić, P., Vedriš, M. (2014). *Građansko pravo*, XIV. izmijenjeno izdanje, Zagreb, Narodne novine, p. 111.

[8] See more about it: Radulović, A. (2014).*Aleatorni ugovori u građanskom pravu Republike Hrvatske*, Informator, (62), no. 6284, pp. 1-3.

[9] For example, the opposite approach to the regulation of the gaming contracts had the French legislator, who defines and lists in article 1964 of the French Civil Code (hereinafter referred to as: CC) which contracts are in fact aleatory contracts.

[10] Games of Chance Act, Official Gazette 87/2009, 35/2013, 158/2013, 41/2014, 143/2014.

event (article 2 of the GCA)". Also, it is useful to stress out that not all Member States of the European Union have defined the games of chance, but the ones that do have, define the games of chance as "games that offer an opportunity to compete for prizes, where success depends completely or predominantly on coincidence or unknown future result and cannot be influenced by the player".[11]

According to Croatian law there are several types of games of chance. The GCA defines the casino games[12], betting games[13], slot machines games[14] and the lottery games[15]. General definition of the games of chance in article 2 of the GCA, as well as the definition of particular games in article 4 point 7-10 of the GCA are, from a nomotechnical point of view, not common definitions of the contracts defined by the Obligations Act[16] (hereinafter referred to as: OA). Therefore, the GCA defines different games of chance but it doesn't provide us with a specific regulation of rights and obligations of the contractual parties.

Since there is no precise regulation of the gaming contracts as well as of the relationship between the contractual parties, fortunately there is a possibility of the application of the Austrian General Civil Code from the year 1811[17] (hereinafter referred to as: AGCC) on the relationship between person concluding such contracts.[18] Pursuant to article 1 and article 2 of the Act on Modus of Application of Legal Regulations Adopted Prior to April 6, 1941[19]. The AGCC would be applicable as a legal regulation on the relations which are not regulated by the legal regulations which are in force in the Republic of Croatia, if the provisions of AGCC are in accordance with the Constitution and the laws of the Republic of Croatia. Regarding gaming contracts which are elaborated in this paper, §§ 1267-1292 of the AGCC can be of relevance.[20] As a possible problem regarding the applications of these provision on games of chance, we can mention § 1274 of the AGCC, according to which article the state lotteries are not to be considered as games and bets, but they should be defined according to the specifically announced regulations.

According to the GCA, gaming contracts are mostly concluded between players and operators of the games of chance, with an exception regarding the casino games, where players can play against each other. Player as a consumer can be any natural person, while the GCA precisely prescribed and limited who can be the operator of the games of chance. The

[11] Commission staff working document: Online gambling in the Internal Market; Accompanying the document: Communication form the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: Towards a comprehensive framework for online gambling ; COM(2012) 506 final, Strasbourg, October 23, 2012., available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0596&from=en, accessed on : March 14, 2017, p. 7.

[12] Article 4, point 7 of the GCA.

[13] Article 4, point 8 of the GCA.

[14] Article 4, point 9 of the GCA.

[15] Article 4, point 10 of the GCA.

[16] Obligations Act, Official Gazette 35/2005, 41/2008, 125/2011, 78/2015. The OA also doesn't provide us with a definition of the aleatory contracts, but according to article 375 paragraph 5 of the Obligations Act, we can reach a conclusion that the Obligations Act recognizes them as a particular group of contracts.

[17] In the Republic of Croatia, that is in one territorial part (Croatia and Slavonia) it entered into force by the Imperial Patent of Francis Joseph I, which was adopted on November 29, 1852. See more: Spevec, F. (1911). *Opći austrijanski Građanski zakonik – treće popravljeno i popunjeno izdanje, Zagreb, Tisak i naklada knjižare L. Hartmana (St. Kugli)*

[18] About the application of the AGCC on gaming contracts and on aleatory legal transactions has already been written. In favour of the application of the AGCC was: Radošević, P. (2010). *Prigovor igre i oklade u bankarskim i burzovnim poslovima;* Pravo u gospodarstvu, 3/2010, pp. 757-759. On the other hand, regarding the application of the AGCC was written with a reservation also by: Radulović, Aldo, op. cit., p. 2.

[19] Act on Modus of Application of Legal Regulations Adopted Prior to April 6, 1941, Official Gazette 73/1991. Regarding that see also: Čulinović, F. (1978). *Državnopravni razvitak Jugoslavije*, Osijek, Štampa, pp. 348-340.

[20] These provisions regulate: Chance agreements (betting, game, lot-gamble) and purchase of things.

right to organize the games of chance has the Republic of Croatia (article 3, paragraph 1 of the GCA), which can transfer that right to Hrvatska Lutrija d.o.o. (article 3, paragraph 3).[21] It means that the operator of the games of chance can only be the company to which the state has transferred its right to organise the games of chance. Because of that, it can be said that the concept of organising of providing of the games of chance partially matches the definition of the state lottery mentioned in § 1274 of the AGCC. It means that the AGCC would be applied on certain contracts, that is on certain games of chance only if the operator of the games didn't regulate in details certain aspects by the general operating conditions, in a way that a certain element of the legal relationship was not regulated at all.[22]
Content of the § 1267 which regulates aleatory contracts can be found in the Austrian General Civil Code (*Allgemeines Büurgerliches Gesetzbuch, hereinafter in text referred to as: ABGB)* that is currently in force, under term *Glücksverträge.*[23] In addition, the AGCC in the group of gaming contract differs and regulates, inter alia, betting (§ 1270, § 1271), game (§ 1272) and lot or gamble (§1273).[24]

2.2. Specific characteristics of the games of chance

In case of gaming contracts, as it was already mentioned, the position of the contractual parties at the moment of the conclusion of the legal transaction is unknown. That outcome or result of the concluded contract depends, in principle, on the future and uncertain circumstance. Legal nature of that circumstance which is unknown at the moment of the conclusion of the legal transaction can be objective and subjective.[25] In addition, at the moment of the conclusion of the contract, one contractual party concludes that contract hoping that the uncertain and future circumstance is going to be realised and that the result of that realization shall be the gain arising for that contractual party, and not for the other contractual party. The gain has to be considered as proceeds of some kind which the contractual parties hope to gain.[26] Therefore, in that kind of contracts, there is always a certain risk which the contractual parties are aware of. Furthermore, regarding gaming contracts, a specific relation is present, which is manifested in a way that the realization of the element of fortune in favour of one contractual party represents the gain for that party, while at the same time it represents the lack of fortune or loss for the other contractual party. That can be considered as one of the reasons why one of the most important principles of the

[21] Additional right to organize the games of chance can be acquired by other companies with a registered seat in the Republic of Croatia (article 3, paragraph 4 of the GCA). More about that see: Opinion of the Ministry of Finance – Tax Department of January 17, 2013 (available at: :http://www.iusinfo.hr/OfficialPosition/Content.aspx?SOPI=MMIN201D20130117Nm971378040&Doc=MMIN_HR, accessed on: March 17, 2017)

[22] Because of that in this paper the general operating conditions of Hrvatska lutrija d.o.o. (https://www.lutrija.hr/cms/OpcaPravilaSudjelovanjaU) , or of some other operator of the games of chance shall be taken into a consideration as one of the sources for the regulation of the relationship of the contractual parties.

[23] It should be mentioned that the provisions of the AGCC, when we compare them to the provisions that are in force today, are not significantly amended. Only article 2 § 1268 was amended. As presented: Klang, H. (2012). *ABGB §§ 1267bis 1292*; Wien,Verlag Österreich, p. 19. See more about it: Binder, M., Denk, C. (2014).*§§ 1090-1292 ABGB, ABGB-Bestandrecht, Werkvertragsrecht, Ehepakte, Glücksverträge, Konsumentenschutzrecht* u: Schwimann, M.; Kodek, G. E. (ur.).*ABGB Praxiskommentar - Band 5*,Österreich,LexisNexis ARD ORAC, pp. 998- 997.

[24] See more in: Spevec, Franjo, op. Cit: pp. 394-401.

[25] Similar about that see also: Klang, Heinrich, op. cit, p. 23.

[26] A live animal cannot be a reward in games of chance pursuant to article 4, paragraph 2 point 6 of the Animal Protection Act, Official Gazette 135/2006, 37/2013, 125/2013.

law of obligations – the principle of equivalence, that is the principle of equal value of performances cannot be applied.[27]

The repercussion is that the gaming contracts as aleatory contracts cannot be annulled in case of an excessive loss, which is strictly defined in article 375 paragraph 5 of the OA.[28] The same solution was prescribed by the AGCC[29], and the same solution is today prescribed by the ABGB. One of the characteristics of the gaming contracts is that they cannot be cancelled or amended in case of changed circumstances, in another words *clausula rebus sic stantibus* doesn't apply.[30] Reason for the above mentioned derives from the nature of these contracts, from the fact that the legal position of the contractual parties depends on the uncertain and future circumstance, which can be interpreted as the expectation for the changed circumstances (article 369-372 of the OA). It is necessary to mention that the OA does not contain an explicit provision regarding the non-application of *clausula rebus sic stantibus* on aleatory contracts, but certain legislators have excluded the application of it in case of gaming contracts, for example in Italian Civil Code.[31] Historically, very early question about natural obligations arose. [32] It would be wrong to say that the obligations arising from the gaming contracts today represent the natural obligations. Obligations which arise from gaming contracts are generally enforceable according to Croatian law. As an exception, we can mention the natural obligations which arise from betting and gambling.[33] In addition to that, certain provisions of the AGCC clearly define in which case are particular gaming contracts enforceable. Obligations which arise from bets were enforceable if they were fair and permitted (§ 1271 AGCC). Certain authors have already mentioned that the obligations that arise from bets are enforceable, but that the obligations which arise from games are not.[34] According to current German law, obligations that arise from games and bets are not enforceable, unless they arise from lottery contracts, which lottery is organized by the state (§ 763 and § 762 Abs. 1 of German Civil Code, *Bürgerliches Gesetzbuch*, hereinafter in referred to as: BGB). However, it is necessary to stress out a particular solution of the German legislator, according to which solution the obligations which are not enforceable are also those assumed by the contractual party that lost, and which obligations arose for the purpose of the debt from game or betting in favour of the party that won (§ 762 Abs. 2 BGB). According to French legislation, not all the obligations that arise from the gaming contracts are not enforceable, but only those arising from games and bets (article 1956 of the CC).

[27] Art. 7 paragraph 1 of the OA. See more: Klarić, P., Vedriš, M., op. Cit., p. 380, 381.

[28] Additionally see more and the case law: Decision of the Supreme Court of the Republic of Croatia, of May 8, 2013, reference number Rev x 138/2013-3, ECLI:HR:VSRH:2013:1191; Decision of the Supreme Court of the Republic of Croatia, of July 9, 1991, reference number Rev-283/1991-2.

[29] See: § 1268 AGCC. See more: Rušnov, Adolfo (1891). *Tumač obćemu austrijskomu građanskomu zakoniku*, Zagreb Tisak i naklada knjižare Lav. Hartmana, p. 663.

[30] See: Tako: Bukovac Puvača, M., Mihelčić, G, Tuhtan Grgić, I. (2016). *Can Financial Crisis Lead to the Application of the Institute of Changed Circumstances Under Croatian Law?* u ur: Başoğlu, B. The Effects of Financial Crises on the Binding Force of Contracts - Renegotiation, Rescission or Revision; Switzerland,Springer International Publishing, p. 88.; Radolović, Aldo, op. Cit., p. 2.

[31] See: Petrić, S. (20017*). Izmjena ili raskid ugovora zbog promijenjenih okolnosti prema novom zakonu o obveznim odnosima*, Zbornik pravnog fakulteta Sveučilišta u Rijeci, v. 28, no. , 2007., p. 26, 27.

[32] See for example: Campe, R. (2012). The Game of Probability: Literature and Calculation from Pascal to Kleist, Stanford, California Press, p. 89, 90. Regarding enforceability of the obligations which arise from gaming contracts see more in Greek law: Stathopoulos, M. (2009).Contract Law in Greece, Alphen aan den Rijn,Kluwer Law International, p. 239, 240.

[33] See more: Klarić, P., Vedriš, M.,op. cit., p. 434., Radolović, A., op. cit., p. 2. Napijalo, D. (1992). *Neutužive /naturalne/ obveze promatrane s gledišta nedopuštenih igara na sreću*; Zakonitost : 46, 8-9, p. 1127.

[34] Rušnov A. emphasizes that a bet is enforceable, and that a game is not enforceable. See: Rušnov, A., op. cit. p. 659.

Specific characteristics of the games of chance as contracts are already explained through subjects who conclude these contracts.[35] Fortunately, limitation only applies regarding the operator of the games of chance. That limitation is even greater if we take into the consideration the provisions of the Croatian Criminal Code[36] (hereinafter referred to as: CCC). Should the contract be concluded under art. 327 CCC, it would be considered as a prohibited legal transaction, and it would be void according to article 322, paragraph 1 of the OA. However, conclusion of such contract would be prohibited for one contractual party, in which case article 322, paragraph 2 of OA could be applied, according to which article the contract would still be valid, since there is no other repercussion for that kind of contract according to the CCC. It means that the contract would probably remain in effect, otherwise, only the player who didn't know and couldn't have known that the operator didn't have the permission for the organization of the game of chance, would be entitled to compensation for damage from the unauthorised operator of the game of chance. At the end, special characteristics of the games of chance can be observed taking into consideration the modus of conclusion. Games of chance as contracts are concluded by the acceptance of the offer of the operator of the games. The operator, in a certain way, and depending on the type of the game of chance, promises to make the payment of a certain amount of money, after the player has made the initial payment, in case the uncertain circumstances is realised in favour of the player. Regarding the betting games, the offer consists of the selection of the outcome of the suggested event, like for example result and/or the outcome of a certain sporting event, or of a dog or horse race. Apart from that, the offer contains the possible winning amount which depends on the combination or on the certain event rate. The offer is accepted at the moment of the payment of money, after the event and the result of that event were chosen. The offers are publicly announced[37], which provides them with a characteristic of a public offer. After the conclusion of the contract, player receives a confirmation, based on which he can receive the possible winning amount. In case of the slot machines games, player accepts the offer also by paying a certain amount of money in accordance with the predefined price of the game which is specified on the slot machine.[38] After the payment is made, player chooses one of the offered combinations. In case of the slot machine games and in case of betting games, the offer is not specified as in case of other pecuniary legal transactions of the law of obligations, but the minimum which player has to pay in order to participate in the game is determined. In case of the lottery games, the offer is usually accepted by the payment of the lottery ticket or by purchase of the ticket in case of instant and express lottery.

2.3. Games of chance and consumer protection

Problem of the protection of the consumers who participate in the games of chance is not something new[39], but that problem is once again widely present because of the financial crisis and the over-indebtedness of consumers. The scope of the protection of the consumers in the

[35] See more about it: 2.1. Definition of the term games of chance.

[36] Croatian Criminal Code, Official Gazette 125/2011, 144/2012, 56/2015, 61/2015. According to article 237, paragraph 1 of the CCC it is a criminal offense to, without the approval of the competent authority, organize, announce or promote games of chance with an aim to procure pecuniary gain.

[37] According to the available general operating conditions of the operator of the games of chance Stanleybet (available at: http://www.stanleybet.hr/files/Pravila%20igre.pdf, page 3, article 6, paragraph 2 of the regulations; accessed on April 29, 2017) the offer has to be publicly announced in order to be valid. See similar also the rules of PSK-prve sportske kladionice at: https://www.psk.hr/Pages/Rules; accessed on April 29, 2017).

[38] It is regulated by article 8 of General Operating Conditions for the Slot Machines Games of Hrvatska lutrija d.o.o. ((https://www.lutrija.hr/cms/fgs.axd?id=60963, accessed on April 29, 2017).

[39] See more: Dowie, J., Coton, M.; Miers, D. (1991). *Consumer Protection in Betting*; Journal of Consumer Policy, 14, 1991, pp. 87 – 98.

Republic of Croatia is affected by the fact that these contracts are excluded from certain consumer directives.[40] The most concerning is the exclusion of Directive 2011/83/EU[41] according to which all member states are obliged to implement the solutions by which a complete pre-contractual information would be ensured for the consumers regarding their rights and obligations, as well as the possibility to exercise the right to renounce a contract that has already been concluded, including the repercussions in case the right to renounce the contract is exercised. By analysing the CPA, it has to be stressed out that it would be useful if some of the rights ensured for the consumers, were ensured also for the participants of the games of chance. In spite of that, games of chance that include the payment of consideration, including lottery, casino games and betting, represent, according to article 40, point 3 of the CPA a special category of contracts on which the consumer's rights do not apply. Among the excluded provisions, the biggest problem is the exclusion of article 42 of the CPA, which regulates the obligation of the trader to provide the consumer with all prescribed information, which is one of the fundamental rights of the consumer. Apart from that, general provisions regarding the contracts concluded away from business premises and the distance contracts regulated by articles 57-61 of the CPA, are also not applied. The fact that there is no pre-contractual information obligation can be justified by already mentioned kind of conclusion of these contracts. Indeed, the consumers are informed how to participate in the game, what are the rules of the game and what is the prize. Even the GCA clearly prescribes that the operators of the games in the premises of the casinos have to indicate a notice on responsible playing, on possible risks related to the game and on the real chance of winning (article 43, paragraph 7 of the GCA). On the other hand, when we are talking about a certain particularly vulnerable group of people (gambling addicts, players who conclude such contracts under the influence of alcohol, etc.) who conclude these contracts, the mentioned protection does not seem to be sufficient. That problem has already been recognised which can be detected from General Regulations of the Slot Machine Games of Hrvatska lutrija d.o.o. In case a player is under the influence of alcohol or other intoxicants, manager and other employee of the operator have the right to prevent them from concluding the contract (article 4 of General Regulations of the Slot Machine Games of Hrvatska lutrija d.o.o.). That rule protects the operator, not the player or the consumer. As the attempts to protect the players, certain provisions of the GCA can be mentioned. Before participating in the game, participant is obliged to provide proof of his/her identity, as well to prove that he/she is not underage (article 43, paragraph 1 of the GCA). Apart from that, the operator is entitled to temporary prohibit a certain person from entering a casino and from participating in games of chance, in case of a well-founded assumption that the frequency and the intensity of the participation of that person in the game jeopardize his/her existential minimum, and in case such a request was filed by the institution for protection of family when the participant due to the uncontrolled participating in such games causes damage to himself/herself or to the family he supports (article 43, paragraph 5 of the GCA). This solution can be in Croatian law considered as the only way to prevent the over-indebtedness of the players. In addition, as a form of protection of the players, and which is not explicitly prescribed by the GCA, but is applied in practice is co called cooling faze, which is applied after two hours of continuous playing in case of the on-line players[42] , and that represents a special category of players considering this paper.

[40] See more about that in the introductory part of this paper.

[41] About the importance of this directive see more: Tonner, K., Fangerow, K. (2012). *Directive 2011/83/EU on consumer rights: a new approach to European consumer law?*, Zeitschriftfür Europäisches Unternehmens- und Verbraucherrecht, June 2012, Volume 1, Issue 2, pp. 67–80.

[42] See more: Admiral – playing conditions, available at: www.admiral-entertainment.at/downloads/Spielbedingungen_ST_HR.pdf, accessed on April 30, 2017.

3. ON-LINE GAMES OF CHANCE AND CONSUMER PROTECTION

The European Parliament has in several reports emphasized the importance of the protection of the consumers who conclude gaming contracts on-line, since the infringements of their rights can be multiple, like identity theft, different frauds, money laundry[43], or other activities of the organized crime[44]. The increasing importance of this topic was also contributed by the availability and variety of the games of chance, which the consumer can access via personal computers and via mobile applications, while not knowing at the same time whether the providers of these games are legal (one that is regulated by the national law of a certain member state) or not (one that is not regulated by the national law on by any member state, nor by any other state and which are not under control). That topic is of importance for each member state of the European Union, because the services are provided regardless of whether the provider of the service and the player are in the same member state or not. [45] That was the reason for discussion the result of which was announced in Green Paper on on-line gambling in the Internal Market.[46] There are several reasons why the European legislator decided to make a concrete move regarding the protection of the consumers who conclude these contracts. As the most important reasons, we can mention non-transparent informing of the consumers, irresponsible commercial communication, insufficient protection in case of the insolvency of the operator and generally, inefficient measures of the protection of the consumers. On the one hand problems of the consumers can be social, like spending too much time playing, addictive effect or affect the addiction in a way to prevent the efficient treatment of addiction, an on the other hand the problems can be financial, like uncontrolled money spending**,** which can lead to over-indebtedness of the consumers.[47] Because of the absence of the support for providing the protection of the consumers through a directive[48], that important topic was elaborated through a recommendation.

[43] About that problem see more: Levi, M. (2010). *E-gamingandmoneylauneringrisks: a European overview*, ERA Forum, 10, 2009, pp.533-546.

[44] See for example: Committee on the Internal Market and Consumer Protection: Report on online gambling in the Internal Market (2011/2084(INI)), 14 October 2011, A7-0342/2011 (available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2011-0342+0+DOC+XML+V0//EN&language=hr, last seen: May 18, 2017.) and Committee on the Internal Market and Consumer Protection: Report on online gambling in the internal market (2012/2322(INI)), 11 June 2013, A7-0218/2013 (available at: http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2013-0218&language=EN, last viewed: May 18, 2017.).

[45] Numerous issues related to providing gaming services were fortunately elaborated by the European Court. Regarding summary of the relevant case law see more: van den Bogaert, S., Cuyvers, A. (2011). *Money for nothing": The case law of the EU court of justice on the regulation of gambling*; Common Market Law Review 48, Kluwer Law International, pp. 1175-1213.

[46] European Commission: Green Paper On on-line gambling in the Internal Market, March 24,. 2011, COM (2011) 128, final, (available at: http://ec.europa.eu/internal_market/consultations/docs/2011/online_gambling/com2011_128_en.pdf, accessed on: May 16,2017).

[47] See more about that: European Commission: Commission staff working document: Executive summary of the impact assessment (Accompanying the document): Commission Recommendation on common principles for the protection of consumers and players of online gambling services and for the prevention of minors from gambling online; July 14, 2014. ({C(2014) 4630}, {SWD(2014) 232}), p. 2, 3 (available at: http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2014/swd_2014_0233_en.pdf, accessed on April 14, 2017).

[48] See more: about harmonization of internal market from aspect of online gambling see more: Casabona, S. (2014).*The EU's online gambling regulatory approach and the crisis of legal modernity*, EUC Working Paper, No. 19, J 2014., January 19, 2014 p. 3.

The European Commission adopted on July 14, 2014 Recommendation 2014/478/EU of 14 July 2014 on principles for the protection of consumers and players of online gambling services and for the prevention of minors from gambling online, [49]. The Recommendation contains a variety of measures with a goal to encourage the member states to a voluntarily harmonization by self-regulation without any sanction in case the measures would not be executed. Recommendation 2014/478/EU also follows the trend of the legislators, since it doesn't regulate games of chance as contracts, but it emphasizes the term gambling service.[50] Furthermore, there is a distinction between the term consumer and the term player along with the definition of minors.[51] Hereinafter the only most important parts of the recommendation shall be presented. Similar to the common consumer protection which is provided through the pre-contractual informing, according to the recommendation, the most important part is the information that should be available to the players. The mentioned information are: details regarding the operator, clear prohibition regarding the participation of minors and the information on responsible gambling, as well as the terms and conditions of the contractual relationship between the operator and the consumer (art. 4 and 5 Recommendation 2014/478/EU). Stimulation of responsible gambling is of great importance, in which way the players would be fully informed about the consequences and risk related to conclusion of these contracts, and it could have been more specified considering the adverse effects already mentioned in the documents of the EU. Specific part of the protection of the players should be realised during the registration of the players and during the creation of the account for playing. The goal is to enable the check of the identity of the players, which should be, on one hand, conducted within the reasonable period of time, but on the other hand it should ensure that the identity of the person who is applying is true.[52] Because of that the member states should adopt rules which would ensure that the players' funds are protected and can only be paid out to the player, and are kept separate from the operator's own funds" and to „avoid collusion by players and money transfers between them including rules regarding annulment of transfers or recovery of funds from player accounts where collusion or fraud is detected" (Art 23 Recommendation 2014/478/EU). The protection should be ensured also during playing and not only in the phase of registration. The protection should be realised through the limitation of the monetary deposit (for example by determining the maximum amount that can be paid in) and through the limitation of the time that can be spent playing, by activation of the time-out or even by self-exclusion (art. 24 and 32 of Recommendation 2014/478/EU). Player should have the possibility to, at any time, obtain the information regarding the paid deposits and realised gain, while the operators should react in case they notice potential risky behaviour of the players. Regarding the prevention of the over-indebtedness, recommendation according to which it should not be allowed for credit to be provided to the player by the operator (art. 28 of Recommendation 2014/478/EU) is of significance. Furthermore, players are protected within the commercial communication of the operator, as well as within the sponsorship.[53]

[49] Commission Recommendation of 14 July 2014 on principles for the protection of consumers and players of online gambling services and for the prevention of minors from gambling online Text with EEA relevance, OJ L 214, 19.7.2014, pp. 38–46, hereinafter referred to as (Recommendation 2014/478/EU).

[50] In article 3 of Recommendation 2014/478/EU they are defined as „any service which involves wagering a stake with monetary value in games of chance, including those with an element of skill, such as lotteries, casino games, poker games and betting transactions that are provided by any means at a distance, by electronic means or any other technology for facilitating communication, and at the individual request of a recipient of services".

[51] See and compare art. 3 (b), 3 (c) along with minors in section V of Recommendation 2014/478/EU.

[52] About that see more: articles 15 – 23 of Recommendation 2014/478/EU.

[53] About that see more: art. 39-48 of Recommendation 2014/478/EU.

Also, member states should pay particular attention to education and awareness, and to raise awareness among the public through campaigns with the already existing organizations for the protection of the consumers.

4. CONCLUSION

In the paper a thesis according to which the games of chance are a specific category of contracts from the aspect of the consumer protection, was confirmed. For that purpose, relevant provisions of the OA, GCA and AGCC were mentioned, including the ABGB, as well as the regulations regarding organising the games of chance. As particularities of the games of chance as contracts, the issue of the enforceability, the issue of the impossibility of the annulment in case of an excessive loss, the issue of the impossibility of the cancellation in case of changed circumstances (*clausula rebus sic stantibus*) and the procedure regarding the conclusion of these contracts, were pointed out. All that, and especially how these contracts are concluded, has shown that the right to withdrawal and the obligation of the pre-contractual informing as most important consumer rights couldn't be applied in these cases. It does not mean that the participants in the games of chance don't have any information about the contracts they conclude. On the contrary, the research has for example shown that they are informed of the amounts they can pay in and of the possible gain, as well of the rules of the game. Regarding the games of chance, the pre-contractual informing, in order to use it for the maximum protection of the consumers, should ensure that the players are clearly informed of the financial and of social consequence of the conclusion of such contracts. Since it is impossible to apply the common consumer rights as they are applied in case of consumer contracts, the protection should be ensured by using the specific mechanisms of protection. It would be possible to limit the deposits which could players pay in, in a certain period of time, or to prevent them from participating in the game after they have spent the amount equal to daily limit, and always to exclude the minors and the person clearly incapable of making judgements (due to the influence of alcohol or drugs) from conclusion of these contracts. The mechanisms of protection which should be developed, would have to be diverse, considering the particular games of chance and whether the game is played on-line or not. Although the directives which exclude their application on these contracts mention that these are the contracts in which the consumers are particularly vulnerable, at European Union level there was no interest for the protection of the consumers to be ensured this way, moreover, the institutions were against it. Because of that, Recommendation 2014/478/EU was adopted, with a goal to stimulate the member states to form their own mechanisms of protection of the consumers – participants in the games of chance. Recommendation 2014/478/EU proposes new mechanisms for the protection of the consumers, which are adjusted for the situations when the contracts are concluded on-line, such as activation of time-out, self-exclusion, identity checking, etc. On the other hand, there are certain negative elements of Recommendation 2014/478/EU, and they are primarily related to the fact that it is a recommendation which does not oblige the national legislators to ensure the proposed protection. Finally, it can be concluded that the protection of the players as consumers, and especially the protection which would prevent their risky behaviour and over-indebtedness, does not exist.

ACKNOWLEDGEMENT: *This work has been fully suported by the Croatian Science Foundation under project number 5269, Civil Law Protection of Citizens in the Financial Crisis/CitProtect, http://citprotect.pravo.unizg.hr/index.php?id=38.*

LITERATURE:

1. Barron, J. M., Staten, M. E. and Wilshusen S. M. (2002). *The impact on casino gambling on personal bankruptcy filing rates*; Contemporary Economic Policy, vol. 20., issue 4, p. 440-455
2. Binder, M. and Denk, C. (2014). *§§ 1090-1292 ABGB, ABGB-Bestandrecht, Werkvertragsrecht, Ehepakte, Glücksverträge, Konsumentenschutzrecht* in: Schwimann, M., and Kodek, G. E. (ur.): ABGB Praxiskommentar - Band 5, Lexis Nexis ARD ORAC
3. Bukovac Puvača , M., Mihelčić , G., Tuhtan Grgić, I. (2016). *Can Financial Crisis Lead to the Application of the Institute of Changed Circumstances Under Croatian Law?* in ur: Başoğlu, Başak: The Effectsof Financial Crises on the Binding Force of Contracts - Renegotiation, Rescission or Revision; Springer International Publishing, Switzerland, p. 83 – 100
4. Campe, R. (2012). *The Game of Probability: Literature and Calculation from Pascal to Kleist*, Stanford, California Press
5. Casabona, S. (2014). *The EU's online gambling regulatory approach and the crisis of legal modernity*, EUC Working Paper, No. 19, p. 1-9.
6. Čulinović, F. (1978). Državnopravni razvitak Jugoslavije, Štampa, pp. 348-340.
7. Klang, H. (2012). *ABGB §§ 1267 bis 1292*; Verlag Österreich, Wien
8. Dowie, J., Coton, M., Miers, D. (1991). *Consumer Protection in Betting*; Journal of Consumer Policy, 14, pp. 87 – 98.
9. Klarić, P. and Vedriš, M. (2014). Građansko pravo, XIV. izmijenjeno izdanje, Narodne novine, Zagreb
10. Levi, M. (2009). *E-gaming and money laundering risks: an European overview*, ERA Forum, 10, pp.533-546.
11. Napijalo, D. (1992) *Neutužive /naturalne/ obveze promatrane s gledišta nedopuštenih igara na sreću*; Zakonitost, vol. 46,8-9, pp. 1125.- 1133.
12. Petrić, S. (2007). *Izmjena ili raskid ugovora zbog promijenjenih okolnosti prema novom zakonu o obveznim odnosima*, Zbornik pravnog fakulteta Sveučilišta u Rijeci, v. 28, br. 1, pp. 1-49
13. Radošević, P. (2010). *Prigovor igre i oklade u bankarskim i burzovnim poslovima; Pravo u gospodarstvu*, 3/2010, pp.757 – 759.
14. Radulović, A. (2014). *Aleatorni ugovori u građanskom pravu Republike Hrvatske*, Informator, (62), no. 6284, pp. 1-3.
15. Rušnov, A. (1891) Tumač općemu austrijskomu građanskomu zakoniku; Tisak i naklada knjižare Lav. Hartmana, Zagreb
16. Spevec, F. (1911). Opći austrijanski Građanski zakonik – treće popravljeno i popunjeno izdanje, Tisak i naklada knjižare L. Hartmana (St. Kugli), Zagreb,
17. Stathopoulos, M. (2009). Contract Law in Greece, Kluwer Law International, Alphen an den Rijn
18. Tonner, K. and Fangerow, K. (2012). *Directive 2011/83/EU on consumer rights: a new approach to European consumer law?*, Zeitschrift für Europäisches Unternehmens- und Verbraucherrecht, Volume 1, Issue 2, pp 67–80.
19. van den Bogaert, S., Cuyvers, A. (2011). *„Money for nothing": The case law of the EU court of justice on the regulation of gambling*; Common Market Law Review 48, Kluwer Law International, pp. 1175-1213.

THE IMPORTANCE OF ORGANIZATIONAL AUTONOMY AND INNOVATION IN HEALTHCARE SERVICE

Sandra Raquel Alves
CIC.DIGITAL; Polytechnic Institute of Leiria; ESTGF, Polytechnic of Porto, Portugal
raquel.alves.pt@gmail.com

Rui Vieira
IESE Business School, Madrid, Spain; University of Amsterdam, Netherlands
rjovieira@gmail.com

Humberto Ribeiro
GOVCOPP; ESTGA, University of Aveiro, Portugal
humberto@alumni.dmu.ac.uk

ABSTRACT

Following the rapid changes in global competitiveness, a number of developments have emerged with regard to organizational structures. One of the main developments reported in the literature in relation to these developments is related to the introduction or developments in organizational autonomy. As the healthcare sector is one of the fastest growing sectors of activity in recent years (Ezzamel and Willmott, 1993; Evans, 1998; Mensah, 2000), it is therefore of interest to assess the extent to which healthcare organizations have introduced or reinforced the role of autonomy, in the scope of an innovative attitude.

Accordingly, this paper highlights the importance of innovation and autonomy for the healthcare sector. The research follows a strategic typology, structured in a seminal way by Miles and Snow (1978), with the aim of examining the extent to which a given hospital organization is focused to meet the needs of a dynamic market, or took advantage of the opportunities offered within this sector by making changes in the range of services offered. The findings of this paper suggest that not only the organizational innovation in service is positively related to a higher level of structural autonomy, but also that structural autonomy is positively associated with the implementation of performance measurement systems from the standpoint of improving the resource management performance. Similarly, the results shown in this paper do also suggest that structural autonomy is positively related to the implementation of performance measurement systems, from a clinical management performance enhancement perspective. Furthermore, one can argue that our results corroborate theoretical formulations and findings obtained previously in other studies, such as in the case of Abernethy and Lillis (2001), and Govidarajan (1988). Indeed, the results obtained for the Portuguese healthcare sector are robust and consistent with other found overseas, as it is the case of Australia (Abernethy and Lillis, 2001).

Keywords: *Autonomy, Clinical Management Performance, Healthcare, Innovation, Performance evaluation systems, Resource Management Performance.*

1. INTRODUCTION

Following the rapid changes in global competitiveness, a number of developments have emerged with regard to organizational structures. One of the main developments reported in the literature in relation to these developments is related to the introduction or developments in organizational autonomy (eg Dean et al.; 1992; Miles and Snow, 1992; Preston et al., 1992; Abernethy and Chua, 1996; Sewell, 1998; Scott and Tiessen, 1999; Abernethy and Lillis, 2001). As the hospital sector is one of the fastest growing sectors of activity in recent years (Ezzamel and Willmott, 1993; Evans, 1998; Mensah, 2000), it is therefore of interest to assess the extent to which Portuguese hospitals have introduced or use organization

autonomy as a way to obtain organizational results within an increasingly competitive environment. In parallel, there is also the possibility of comparing the results obtained in Portugal with other countries, such as Australia, through the aforementioned study by Abernethy and Lillis, (2001).

As advocated by several authors (eg Shortell et al., 1996; Abernethy and Lillis, 2001), the emphasis on service innovation is a significant dimension of the competitive strategy, as hospitals that focus on service innovation will be the most exposed to markets subject to rapid changes, necessitating, therefore, new offers of services provided continuously. In the extreme, similar to Abernethy and Lillis, (2001), it is argued in this paper, that such context allows to identify two types of hospital organizations. On the one hand, there are more conventional hospitals, resistant to change, which are not at the forefront in terms of the provision of new services or monitoring market developments in the health sector. For these types of organizations, the new services to be provided tend to focus on the current areas of operation. Its priority will be to do the best work possible in the current set of services, improving existing services, but not valuing policies of incentives or training of its human resources. As an example, as Abernethy and Lillis, (2001), refer, a hospital that would fit into this extreme, could be the classic hospital basically implemented in a particular community that offers services of general medicine and basic surgery, or routine obstetrics, ie, would be one that would simply improve and expand a relatively small and constant set of hospital services. Although it may be involved in innovative activities, however, it is mainly aimed at improving the existing set of services, as this type of hospital is not active in the search for new market opportunities beyond the domains where it operates, and is therefore usually Subject to a low level of innovation of the services provided, because it simply maintains its market share through efficiency (Abernethy and Lillis, 2001).

On the other hand, there are hospital organizations that, subject to relatively frequent changes in their set of services, tend to offer a wider range of medical services compared to other hospitals of similar size and functionality. These respond quickly to indications of new opportunities or market needs, systematically trying to be at the forefront in developing new services, often being followed by other hospitals. They tend to adopt incentive systems and value the training of their human resources. However, this type of hospital may not always hold a strong position in the areas in which it is involved. As Abernethy and Lillis, (2001) refer, an example of this type of hospital will be one that will make it a point to have the most advanced means of diagnostic testing, i.e., one that seeks to hold state-of-the-art medical equipment.

In this paper it is adopted a broad set of performance metrics, which includes both financial and non-financial measures, and which is consistent with diverse literature that deals with the development of SMDs (see Hopwood, 1976; Ittner and Larcker, 1998; Hartmann, 2000; Otley and Fakiolas, 2000). Similarly, the construction of the comprehensive set of metrics used in this research is also based on literature related to the hospital sector and other services that in some way include concepts related to those used in this research (eg Abernethy and Stoelwinder, 1991; Smith, 1993; Lee et al., 2000; Watkins, 2000; Abernethy and Lillis, 2001). In addition to the distinction between financial and non-financial metrics, the classification of the measures used in this paper in terms of performance systems can be distinguished between clinical management criteria and resource management criteria. Like Abernethy and Lillis, (2001:112), such dimensions can be defined as follows: while performance measures associated with resource management include productivity and cost data, thus based on quantitative criteria; the clinical management criterion includes measures related to the clinical care of patients and research, as well as qualitative criteria considered important for the effective management of the clinical unit. Concurrently, it is expected that the importance attributed to these measures by hospital organizations is proportional, or at

least influenced, by the degree of autonomy delegated to clinical units (Abernethy and Lillis, 2001). This research follows a strategic typology structured by Miles and Snow, (1978), such as Abernethy and Lillis, (2001), with the aim of examining the extent to which a given hospital organization was focused to meet the needs of the market, or took advantage of the opportunities offered within this sector by making changes in the range of services offered. Adopting this strategy type is advantageous because it has already been tested for its theoretical strength (Doty et al., 1993). Additionally, it has also been examined considerably in terms of metrics within the social sciences, particularly with regard to psychology (Snow and Hrebiniak, 1980; Shortell and Zajac, 1990).
Finally, as in Abernethy and Lillis, (2001), in this paper it is argued that the decisions that lead to the delegation of financial and clinical management competencies are influenced by the coordination and cognitive demands imposed by a strategic orientation in the organizational innovation in the provision of services.

2. STRUCTURAL AUTONOMY AS A WAY OF ACHIEVING ORGANIZATIONAL INNOVATION

The literature points out that the search for innovation as a strategic priority has implications for the type of structural adjustments needed to facilitate innovative and creative activity (see Miller, 1987; Naman and Slevin, 1993; Miles et al., 2000). Innovative organizations have to adapt quickly to market forces (Habib and Victor, 1991; Slater and Olson, 2000; Abernethy and Lillis, 2001). Given this framework, it will be expected that organizations will need to be constantly concerned with the adequacy of their processes, often initiating reorganizations and even restructuring, in order to ensure the capacity to respond to the challenges imposed continuously by the market, as best practices. To achieve this, the organizational structure must ensure that the flow of information is efficiently transmitted by the organization, both horizontally and vertically, and should encourage individual work units to collaborate with each other during the provision of basic services. Such autonomous units one of the possible means (Lawler, 1993; Cohen and Ledford, 1994; Scott and Tiessen, 1999; Bouwens and Abernethy, 2000; Abernethy and Lillis, 2001). In addition to generating possibilities for collaboration, the creation of autonomous units of work enhances the sharing of resources, as well as the improvement of organizational results, measured both in efficiency and/or efficiency gains, and this is one of the fundamental assumptions of this research (see Gupta et al., 1997; Abernethy and Lillis, 2001). As Kaplan and Atkinson (1998), point out, the autonomous units are closer to the market and therefore can obtain and interpret information related to the requirements of the markets, generating outputs, as well as knowing where the sources of resources (inputs) are located. Given that the delegation of autonomy to operational units enhances the exchange of information between the organization and the environment, these units will not only be more knowledgeable about market conditions, but will also be better able to make the necessary adjustments in response to the continuous changes demanded by ongoing dynamics outside the organization (see Abernethy and Lillis, 2001).
In the view of Bouwens and Abernethy, (2000), and Abernethy and Lillis, (2001), who distinguish hospital organizational dynamics in terms of the degree of innovation incorporated, it is argued in this paper that hospitals that do not seek service innovation face a Lower level of diversification and change in their set of clinical services, and are subject to a smaller set of reporting requirements, so they do not struggle with information limitations that are usually associated with a centralized organizational structure. In this type of organization, there is a strong propensity to maintain a centralized system, since this centralization allows to minimize dysfunctional behaviours that are not rarely created by the delegation of competences, as well as to mitigate the risk of inconsistencies in the definition

and achievement of organizational objectives (Shortell et al., 1996; Abernethy and Lillis, 2001). In reality, in centralized, typically hierarchical and multilevel organizational structures, the amount of information that can be effectively processed is limited because the decision-making process is centralized, and this type of organization may be considered relatively inflexible and therefore unable to respond quickly (Galbraith, 1977; Daft and Lengel, 1986; Abernethy and Lillis, 2001). In structures where decision-making is centralized, it tends to be delayed, since information is usually communicated vertically and is slow to be processed by management itself, which is centralized, and therefore limited in resources, resulting in this type of limitation, and contributing to reduce the ability of top management to process large amounts of information, and decreasing its capacity for effective control and coordination of core activities at the lower strata of the organization (see March and Simon, 1958; Burns and Stalker, 1961; Gordon and Narayanan, 1984; Abernethy and Lillis, 2001). This limitation is particularly relevant in the hospital sector, where top management does not have sufficient clinical capacity for efficient clinical decision-making (Young and Saltman, 1985; Abernethy and Lillis, 2001).

However, the fact that a hospital organization is governed by a traditional hierarchical structure does not mean that it does not operate with autonomous work units. In fact, as Abernethy and Lillis, (2001), point out, given the limitations mentioned above, in particular as regards the limitations of coordination of top management, one could expect that autonomous units of work would be created within this type of organization. However, the creation of autonomous units of work entails costs, such as: reduction of loyalty to the organization in general; the possibility of behaviours that are not aligned with the objectives of the organization; and sub-optimal decision-making at lower-level management level (Zimmerman, 1997; Kaplan and Atkinson, 1998; Abernethy and Lillis, 2001). In this way, it will be expected that the most innovative organizations will be those with the highest levels of autonomy. While in the case of hierarchically structured hospitals, this is only to be expected in the case of those who seek service innovation as a strategic priority, despite the limitations mentioned before, as well as the need for a greater diversification of clinical skills. Finally, the management of clinical units in hospitals has traditionally been the responsibility of physicians who enjoy considerable autonomy in the clinical processes and results of medical treatment, which gives them almost complete control over key operational tasks, but which (Galbraith, 1977; Dougherty and Hardy, 1996; Slater and Olson, 2000; Abernethy and Lillis, 2001).

A greater degree of autonomy may be formalized through an organizational process of decentralization. Decentralization is one of the important structural mechanisms to facilitate the effectiveness of strategic execution (Chandler, 1962; Rumelt, 1974; Vancil, 1980; Govindarajan, 1988). In addition, decentralization is seen as important for decision-making in terms of authority that is delegated to a manager of strategic business units by the hierarchically superior firm (Ford and Slocum, 1977; Govindarajan, 1988). Previous research has concluded that a high level of decentralization is an important response to increased uncertainty (Burns and Stalker, 1961; Lawrence and Lorsch, 1967; Galbraith, 1973; Tushman and Nadler, 1978; Govindarajan, 1988). According to this assumption, as the envelope of a task becomes more uncertain there will be a need to collect more information. In turn, centralization is possible with low levels of uncertainty since the information processed does not overload the organization's hierarchy. However, as the uncertainty increases, so do the exceptions that have to be announced to higher levels of the hierarchy. The more exceptions are directed bottom-up the more hierarchy will be overloaded. "Significant delays develop between forwarding information about new situations and responding to this information in a downward direction. An effective way of responding to this situation will be to shift the level of decision-making where information exists, rather than to move it to higher levels of the

hierarchy, thus suggesting that decentralization of decision-making is a response to increased Scenarios of uncertainty "(Govindarajan, 1988: 833). Govindarajan, (1988), hypothesized that for strategic business units that employ a strategy of differentiation, an increase in decentralization is likely to be associated with a high effectiveness of SBUs. Thus, for strategic business units that rely on a low-cost strategy, an increase in centralization is likely to be associated with high effectiveness of SBUs. In addition to the issues related to uncertainty, there is another argument that supports the development of this hypothesis, which has to do with the fact that interdependence with other business units is more beneficial to the low-cost SBU than to a differentiated SBU. Since sharing of activities contributes to minimizing costs in general, which is more important for a low cost unit (Gupta and Govindarajan, 1986; Govindarajan, 1988). Previous studies have concluded that with the high degree of interdependence the centralized decision-making process improves performance because the effects of managers' decisions on the performance of other units leads to the need for effective coordination and joint problem solving (Thompson, 1967; Lorsch and Allen, 1973; Vancil, 1980; Govindarajan, 1988).

Since the surrounding environment is dynamic, the success and failure of employees' actions can be attributed to all that is controlled by them, but also by uncontrollable factors, that is, external factors. This orientation is known as locus of control, whose embryonic study was published in 1954 by Julian Rotter, who investigated how people's behaviour and attitudes could affect their lives accordingly. The external locus of control consists of the consequences out of control, determined by fate and independent of variables that individuals can control, such as hard work or the decisions they have made. On the other hand, the internal locus of control consists of the consequences of what is controlled by individuals, such as work performed, talents and taxes or results of decisions. Individuals who develop an internal locus of control believe that they are responsible for their own success, while those who develop the external locus control believe that external forces, such as luck, determine the results they can achieve.

Under conditions of high uncertainty there are two groups of studies that concluded that the internal locus of control's target performers perform better than the external locus of control. The first group of studies focused on examining individuals' ability to obtain and use information, and concluded that: (i) individuals with an internal locus seek information relevant to the performance of tasks more actively than those with an external locus (Davis et al., Phares, 1967; Pines and Julian, 1972; Organ and Greene, 1974; Govindarajan, 1988); (ii) the first group, ie internal locus, is more efficient in the use of information than the second group (Phares, 1968; Wolk and DuCett, 1974; Spector, 1982; Govindarajan, 1988). The logic underlying the superior information processing capacity of individuals with an internal locus is based on presumed construct properties in an internal - external dimension. Individuals with the internal locus and having a high expectation that the rewards will be earned in their own efforts should actively seek information related to the tasks, and should also use this information, since they should consider obtaining and using relevant information as a way to strengthen their positions. On the other hand, individuals with external locus believe that their efforts are not important for rewards, so they do not actively seek to obtain or use information. Galbraith, (1973), argues that the greater the uncertainty the greater the amount of information that has to be processed, so it will be expected that individuals with internal locus can deal more effectively with uncertainty than those with external locus.

The second group of studies focuses on the relationship between uncertainty and the locus of control more directly by providing evidence suggesting that those with an internal locus of control are better suited to changes in the environment than those with an external locus Gore and Rotter, 1963; Mitchell et al., 1975; Ford and Slocum, 1977; Govindarajan, 1988). In relation to the hypotheses constructed for this paper and presented in the following sections,

it is believed that the set of performance and control systems possibly designed by hospital organizations can lead their employees to strengthen their internal locus of control. In this sense the following hypothesis could be formulated in the image of Govindarajan, (1988): for the SBUs that employ a strategy of differentiation, a greater locus of internal control by the main manager of a SBU is possibly associated with a high efficiency of a SBU. For SBUs that use a low-cost strategy, a greater locus of external control by the senior manager of an SBU is possibly associated with a high effectiveness of this SBU. However, this proposition needs adjustment to the specific framework of this research, as reflected in the following hypothesis formulated and presented below.

H1: There is a positive relationship between a strategic emphasis on service innovation and the extension of delegated autonomy to hierarchically inferior units.

In summary, this paper follows the suggestion of Abernethy and Lillis, (2001), who argue that decisions that lead to the delegation of financial and clinical management competencies are influenced by the coordination and cognitive demands imposed by a strategic orientation in the organizational innovation in the provision of services, thus allowing to formulate the first research hypothesis of this paper.

3. AUTONOMY AND PERFORMANCE MEASUREMENT SYSTEMS

"The Imperial Rater of Nine Grades seldom rates men according to their merits, but always according to his likes and dislikes." Sin Yu, Chinese philosopher, Wei Dinasty, circa 287 A.D. (Patten, 1977:352).

The management of competitive requirements resulting from autonomy and accountability has long been recognized as important by academic research and has received increasing attention from the public sector as governments have increasingly been concerned with the management of conflicting extensions between the demands of decentralization and the demand for greater accountability for the results obtained, which has resulted in an increase in the adoption of results-oriented efficiency and service-delivery measures within the sector (vid. Solomons, 1965; Lawrence and Lorsh, 1967; Vancil and Buddrus, 1979; Lapsley, 1994; Bromwich and Lapsley, 1997; Mouritsen and Bekke, 1997; Ittner and Larcker, 1998; Groot 1999; Jones, 1999; Abernethy and Lillis, 2001; Flamholtz et al., 1985). In this paper, we present an overview of the literature on the use of accounting techniques in the literature. The growing trend towards accountability concerns is more important than the fact that such measures have increasingly been applied in the hospital sector (Forgione, 1997; Jones and Dewing, 1997; Chow et al., 1998; Abernethy and Lillis, 2001).

Both practitioners and academics have come to recognize that, despite the classic utility of financial indicators for the overall assessment of organizational performance, they have nevertheless proved inappropriate in the face of increasing challenges posed by diverse phenomena, such as the globalization process (eg, Eccles, 1991; Fisher, 1992; Kaplan and Norton, 1996; Ittner and Larcker 1998; Neely, 1999), leading several authors to try to improve such financial indicators or alternatively to use non-financial ones (Kaplan and Norton, 1996; 2001, Stern et al., 2004).

Like Abernethy and Lillis, (2001), it is argued here that performance measurement systems (SMDs) can be conceptualized as comprehensive accountability systems designed to capture the activities performed in clinical units. As reported by Neely et al., (1995), SMDs, or performance measurement systems (PMSs), consist of individual measures of performance that can be categorized in a variety of ways, from the Balanced Scorecard of Kaplan and Norton, (1992), to the framing of results and determinants drawn by Fitzgerald et al., (1991).

In this paper is adopted a broad set of performance metrics, which includes both financial and non-financial measures, and which is consistent with diverse literature that deals with the development of SMDs (see Hopwood, 1976; Ittner and Larcker, 1998; Hartmann, 2000; Otley and Fakiolas, 2000). Similarly, the construction of the comprehensive set of metrics used in this research is also based on literature related to the hospital sector and other services that in some way include concepts related to those used in this research (eg Abernethy and Stoelwinder, 1991; Smith, 1993; Lee et al., 2000; Watkins, 2000; Abernethy and Lillis, 2001). In addition to the distinction between financial and non-financial metrics, the classification of the measures used in this paper in terms of performance systems can be distinguished between clinical management criteria and resource management criteria. Like Abernethy and Lillis, (2001:112), such dimensions can be defined as follows: while performance measures associated with resource management include productivity and cost data, thus based on quantitative criteria; the clinical management criterion includes measures related to the clinical care of patients and research, as well as qualitative criteria considered important for the effective management of the clinical unit. Concurrently, it is expected that the importance attributed to these measures by hospital organizations is proportional, or at least influenced, by the degree of autonomy delegated to clinical units (Abernethy and Lillis, 2001).

Delegation of competencies may entail some limitations, as mentioned by Merchant, (1998), the development of autonomous work units may limit the ability of top management to closely monitor and supervise the activities performed by clinical units. However, accountability mechanisms, such as standard operating rules and procedures, which can be used in an attempt to induce desired actions of subordinate managers, are not precluded by the nature of the work carried out under delegation with a deliberate degree of autonomization (Abernethy and Stoelwinder, 1995; Abernethy and Lillis, 2001). However, not only top management, or hierarchically superior management, does not sufficiently master technical skills at the clinical level in order to architect and implement standard operating procedures. Nor can it be expected that such procedures may mitigate the problems of communication between those responsible for management in general and those responsible for performing clinical activities, it being understood that predominant clinical professionals, such as physicians, are known to be resistant to attempts to implementation of procedures and bureaucratic rules on the part of the administration, which may in some way threaten their autonomy (see Freidson, 1975; Jonsson and Solli, 1993; Abernethy and Lillis, 2001). In these cases, the sensitivity and capacity of top management may prove to be fundamental. As Scholtes, (1997:49), states, "if leaders do not understand and lead systems, organizations and communities will forever fail and will probably not survive.".

Indeed, various literature suggests that clinicians naturally prefer to work within frameworks free of accountability mechanisms, as well as free from any procedures and values other than those imposed by the profession itself (Ouchi, 1977; Abernethy and Stoelwinder, 1991; Merchant, 1998; Abernethy and Lillis, 2001). However, as Abernethy and Lillis, (2001:113), refer, such values and norms stemming from professional ethics and professional ethics will not be sufficient for hospital top management, since the loss of potential control is high whenever input and output decisions are autonomously delegated to clinical units. Consequently, the hospital management will probably prefer to supplement this control through the implementation of performance measurement systems that, in addition to assessing the results of clinical activities, also serve the accountability function by obtaining concurrent results, allowing clinicians to maintain the desired autonomy over the means associated and required to perform complex tasks. In fact, this form of control can bridge the communication gap between clinical practitioners and management by translating primary

activities such as professional activity into side effects such as quantifiable outcomes (Jonsson and Solli, 1993; Abernethy and Lillis, 2001).
In summary, as conceptualized by Abernethy and Lillis, (2001), it is expected that an increase in autonomy can be accompanied by an increase in accountability, and this is reflected in an increased importance addressed to performance measurement systems, since it will be expected that the importance of MDSs increases as a Portuguese healthcare organization extends the autonomy of clinical work units. Therefore, one can consider the following hypothesis:

H2: There is a positive relationship between the level of autonomy and the extent of the performance evaluation of a hospital's professional board.

Additionally, as autonomy extends beyond clinical outcomes to encompass both inputs and outputs - that is, financial resource management and the volume and set of clinical services, respectively, it will be expected that the importance performance measures may increase in relation to both measures of resource use and clinical management (Abernethy and Lillis, 2001:113). In this way the hypothesis bellow can be formulated as well:

H3: There is a positive relationship between the level of autonomy and the extent of clinical management performance assessment.

4. METHODOLOGY OF ANALYSIS AND VARIABLES DESIGN

The research design comprises a field study targeting the healthcare sector in Portugal. A survey was designed in order to allow testing the research hypotheses shown before in this paper. Questionnaires and interviews were conducted, inquiring diverse responsible people, both at the clinical and management level, working in hospitals and clinics. The preparation of the questionnaires was preceded by pilot interviews with experts in the field of the hospital sector, and exploratory interviews were previously conducted as well. The majority of questions were used a Likert response scale of 7 levels, with different degrees of qualitative assessment. The preparation and construction of the variables used in this research is shown in the next sections.

4.1. Structural autonomy

As for the measurement of structural autonomy, an instrument based on four items was originally constructed by Govindarajan, (1988), and later adapted by Abernethy and Lillis, (2001). This instrument focused on the delegation of decisions related to inputs and outputs, as well as clinical managers needed to indicate the extent of delegation of such decisions to clinical unit managers (Abernethy and Lillis, 2001).
Four items were used to access the level of a possible higher perceived degree of delegation, autonomy and accountability of any units existing in hospitals, such as at the level of clinical departments. In addition, four other items of self-responsibility were added to the questionnaire, whose interpretation is similar to the set referred to above, so that, in terms of results analysis, the assessment will be global, corresponding to the sum of eight possible answers.

4.2. Service innovation

Miles and Snow, (1978), describe the prospector as one who always tries to be the first among the pioneers in the development of new products and/or services, having a high capacity for the exploration and exploitation of market opportunities. In this paper, the key point of interest lies in identifying the hospitals on a scale of between prospector, aggressive in seeking opportunities up to defensive, ie more concerned about keeping the areas where it is already present. Naturally, the classification of hospital organizations from a range of

prospectors versus defensive, follows the logic adopted by Abernethy and Lillis, (2001), based on Miles and Snow, (1978), being focused on the analysis of the level of dedication of these organizations as service innovation, as this is reflected in the consequent degree of change in their service mix. Innovation service is regarded as a continuous, in which one end is shown a hospital involved in little change, while the other end is shown a hospital that is continuously changing the range of services offered. The research presented here adopted the metric used by Abernethy and Lillis, (2001), which operationalized the construction of the representation of a continuous offering, according to two extreme descriptions of the strategic position of a particular hospital, questioning the organization regarding the degree of change and innovation in the supply of services, to be classified by the respondents 1 to 7, within the spectrum of such continuum. More specifically, the questionnaire referred to two types of hospitals, one in the conventional manner, "Hospital type A", resistant to change, which is not in the forefront of offering new services or as to the monitoring of market innovations that have occurred in their sector, which tends to focus on current areas of operation, not valuing incentive policies or the training of its human resources. Therefore, a low score answering this question gives an indication of a classic hospital that is perfectly framed in a community, which offers basic services in general medicine and surgery. Certainly away from a great complexity in terms of providing services, this type of hospital organization may even have some degree of innovation, but necessarily at a very limited scale, because their primary concern will be maintaining the status quo, trying to ensure providing a good level of existing services. On the other hand, a higher score response, gives an indication of a respondent from a "type B Hospital", which corresponds to an organization that tends to offer a wider range of innovative medical services compared to other hospitals, in both similar size characteristics, given subject themselves to a greater extent of rules and market dynamics. In this case, it is about a hospital that conducts relatively frequent changes in its set of services, quickly responding to new opportunities or evidence of new market needs, and therefore is continuously at the forefront of developing new services being followed up by other hospitals. The "type B Hospital" is directed to be an innovation both in terms of services as to the level of information and control systems organization, because there is concern about adopting the most advanced practices in management.

4.3. Performance evaluation systems

Similarly to Abernethy and Lillis, (2001), who used an instrument developed with the purpose of capturing the construction of Performance Measurement Systems (PMS), this research also incorporates the latest research that includes criteria for both quantitative and qualitative performance (Ittner and Larcker, 1998), as well as considers studies carried out in the hospital sector and other service sectors that included similar procedures (see eg Abernethy and Stoelwinder, 1991; Smith, 1993; Lee et al, 2000; Watkins, 2000).

In terms of performance assessment, this paper relates also to the seminal work of Hopwood, (1976), and in subsequent literature (eg Hartmann, 2000; Otley and Fakiolas, 2000), which, however, is only focused on the dimensions of the mechanism developed by Hopwood. In a similar manner, this paper includes also the measurement instrument adopted by Abernethy and Lillis, (2001), who consider seven items as relevant in assessing the performance of clinical units, concluding, from a previous factor analysis that provided support for the identification of the two dimensions of performance measurement (SMD) systems, they could be categorized as follows: i) the items of the performance level of cost and productivity (throughput) represent a more quantitative factor associated with performance management in resources (RMP or resource management performance); ii) while the remaining items represent measures of performance of a more qualitative nature, representing the performance criteria of clinical management (CMP or clinical management performance).

4.4. Variables aggregation

Using factorial analysis, following the Principal Component Analysis methodology, it was possible to aggregate diverse items into specific dimensions. Following the factor analysis made, regarding such identification and dimensional grouping, a set of variables was constructed to test the research hypotheses, are shown below in the table 1.

Table 1 – Variable list

AE	Structural Autonomy
IO	Organizational Innovation
RMP	Resource Management Performance
CMP	Clinical Management Performance

5. RESEARCH SAMPLE

Using a database of healthcare organizations operating in Portugal in the second decade of the current millennium, was possible to obtain feedback from a set of fifty respondents, being three quarters from public healthcare organizations, and the remaining from the private sector. This reflects the healthcare sector status in Portugal, which is dominated by the public organizations, despite the significant growth of the private sector in recent years.

The response rate to the questionnaires sent was around 50%, being slightly higher for public organizations. In terms of characteristics of the hospital sector represented in the sample can be pointed out that, on average, the public sector hospitals are larger and more complex organizational structures. In fact, while the average number of hospital beds in the public sector totals hundreds for each one, this number in the private sector decreases to only a few more than one hundred. Regarding the number of clinical departments of the hospital, it amounts to an average of fifteen for public hospitals, while in the private sector is only about three. As for the experience of the boards and directions, the differences are less significant. Nonetheless, the indicators of seniority are superior in the private sector. In terms of seniority of clinical management, it overcomes the three years in the public sector, and eight years in the private, and the time period of the collaborative clinical director of collaboration with the hospital, not necessarily in a managerial way, exceeds sixteen years in both the public and private sectors. With regard to the administration and/or hospital management, the average time served in role of administration, or similar, is about seven years in the public sector, while the private sector amounts to almost thirteen years. Finally, the period of collaboration in the hospital, not necessarily corresponding to administrative tasks, amounts to ten years in the public sector and thirteen years in the private sector.

6 DISCUSSION OF RESULTS AND CONCLUSIONS

The research hypotheses were tested using correlations between the variables constructed as shown before. Table 2, below, offers a global resume of the results obtained, being such discussed in the following subsections of the paper. In terms of expected signal, the testing hypotheses were constructed assuming a positive correlation. Accordingly, the indication "(+)" means that all correlations mentioned are statistically significant at least at the confidence interval level of 95%, for both Pearson and Spearman ranks.

Table 2 – Hypothesis testing results.

Hypothesis	**Results**
H1: IO_AE	Accepted (+)
H2: AE_RMP	Accepted (+)
H3: AE_CMP	Accepted (+)

6.1. Organizational innovation / service and structural autonomy

There is a positive correlation between IO and AE, with a correlation of 37.9% for 48 observations, statistically significant with a confidence level of 99%, suggesting the non--rejection of Hypothesis 1. Such as in Abernethy and Lillis, (2001), this means there is a positive relationship between a strategic emphasis on service innovation and the extension of autonomy delegated to hierarchically inferior units.

6.2. Structural autonomy and performance measurement systems from the standpoint of resource management performance

Considering 48 observations, there is a positive relationship between AE and RMP, with a correlation of 54.8%, statistically significant in the 99% confidence interval, and therefore the non-rejection of Hypothesis 2 is inferred. It is concluded, therefore, as Abernethy and Lillis, (2001), that there is a positive relation between the level of autonomy and the extension of the evaluation of the performance of the professional hospital board.

6.3. Structural autonomy and performance measurement systems from a clinical management performance perspective:

There is a positive correlation between AE and CMP, with a correlation of 56.1%, statistically significant at 99%, for 47 observations, therefore suggesting not to reject Hypothesis 3. Likewise for this hypothesis, corroborating Abernethy and Lillis, (2001), one can conclude that there is a positive relation between the level of autonomy and the extent of the evaluation of the performance of clinical management.

6.4. Main conclusions

The hypotheses formulated in this paper were not rejected. Moreover, the results obtained suggest a positive relationship between the variables studied. The statistic validation of the results presented here do also suggest that the literature review made, together with the theorization and the testing performed, were suitable to the purposes of the research goals. Furthermore, one can argue that the results obtained corroborate theoretical formulations and previous results obtained also in other pieces of literature used in this investigation, such as the case of the Abernethy and Lillis, (2001), and Govidarajan, (1988). Indeed, the results obtained for the Portuguese healthcare sector are robust and consistent to other obtained overseas, such as in the case of Australia, as found earlier by Abernethy and Lillis, (2001).
This paper highlighted the importance of innovation and autonomy for the healthcare sector. It was possible to conclude that not only the organizational innovation in service is positively related to a higher level of structural autonomy, but also that structural autonomy is positively associated with the implementation of performance measurement systems from the standpoint of improving resource management performance. Similarly, the results shown in this paper suggest as well that structural autonomy is positively related to the implementation of performance measurement systems, from a clinical management performance enhancement perspective.

ACKNOWLEDGEMENT: *This work was financially supported by the research unit on Governance, Competitiveness and Public Policy (project POCI-01-0145-FEDER-006939), funded by FEDER funds through COMPETE2020 - Programa Operacional Competitividade e Internacionalização (POCI) – and by national funds through FCT - Fundação para a Ciência e a Tecnologia.*

LITERATURE:

1. Abernethy, M. A. & W. F. Chua, (1996), "A field study of control system "redesign": the impact of institutional processes on strategic choice", *Contemporary Accounting Research*, Vol. 13, pp. 596-606.
2. Abernethy, M. A. & A. M. Lillis, (2001), "Interdependencies in organization design: a test in hospitals", *Journal of Management Accounting Research*, Vol. 13, pp. 107-225.
3. Abernethy, M. A. & J. U. Stoelwinder, (1991), "Budget use, task uncertainty, system goal orientation and subunit performance: a test of the "fit" hypothesis in not-for-profit hospitals", *Accounting, Organizations and Society*, Vol. 16, Nº 2, pp. 105-120.
4. Abernethy, M. A. & J. U. Stoelwinder, (1995), "The role of professional control in the management of complex organizations", *Accounting, Organizations and Society*, Vol. 20, Nº 1, pp. 1-17.
5. Bouwens, J. & M. A. Abernethy, (2000), "The consequences of customization on management accounting system design", *Accounting, Organizations and Society*, Vol. 25, pp. 221-241.
6. Bromwich, M. & I. Lapsley, (1997), "Descentralization and management accounting in central government: recycling old ideas", *Financial Accountability and Management*, Vol. 13, Nº 2, pp. 181-201.
7. Burns, T. & G. Stalker, (1961), *The management of innovation*, London: Tavistock.
8. Chandler, A. D., (1962), *Strategy and structure: Chapters in the history of the American industrial enterprise*, Cambridge: MIT Press.
9. Chow, C. W.,D. Ganulin, K. Haddad. & J. Williamson, (1998), "The balance scorecard: A potent tool for energizing and focusing healthcare organization management", *Journal of Healthcare Management*, Vol. 43, Nº 3, pp. 263-280.
10. Cohen, S. G. & G. &. Ledford (1994), "The effectiveness of self-managing teams: a quasi-experiment", *Human*, Vol. 47, Nº 1, pp. 13-43.
11. Daft, R. L., & R. H. Lengel. (1986), "Organizational information requirements, media richness and structural design", *Management Science*, Vol. 32, Nº 5, pp. 554–571.
12. Davis, W. L. &. J. Phares (1967), "Internal-external control as a determinant of information seeking in a social influence situation", *Journal of Personality*, Vol. 35, pp. 547-561.
13. Dean, J. W., S. J. Yoon, & G. I. Susman (1992), "Advanced manufacturing technology and organization structure: empowerment or subordination?", *Organization Science*, Vol. 3, Nº 2, pp. 203-229.
14. Doty, D. H., W. H. Glick & G. P. Huber (1993), "Fit, equifinality and organizational effectiveness: a test of two configurational theories", Academy *of Management Journal* Vol. 36, December, pp. 1196-1250.
15. Dougherty, D. & C. Hardy (1996), "Sustained product innovation in large, mature organizations: Overcoming innovation-to-organization problems", *Academy of Management Journal* Vol. 39, Nº 5, pp. 1120-1153.
16. Eccles, R. G. (1991), "The Performance Measurement Manifesto", *Harvard Business* Review, Vol. 69, January-February, pp. 131-137.

17. Evans, J. H. (1998), "Cost management and management control in health care organizations: research opportunities", *Behavioral Research in Accounting*, Vol. 10, pp. 78-93.
18. Ezzamel, M. & H. Willmott (1993), "Corporate governance and financial accountability: recent reforms in the UK public sector", *Accounting, Auditing & Accountability Journal*, Vol. 6, Nº 3, pp. 109-132.
19. Fisher, J. (1992), "Use of Nonfinancial Performance Measures", *Journal of Cost Management*, Vol. 6, Nº 1, pp. 31-38.
20. Fitzgerald, L., R. Johnston, S. Brignall, R. Silvestro & C. Voss (1991), *Performance Measurement in Service Business*, London: CIMA.
21. Flamholtz, &. G., T. K. Das & A. S. Tsui (1985), "Toward and integrative framework of organizational control", *Accounting, Organizations and Society*, Vol. 10, Nº 1, pp. 35-50.
22. Ford, J. D. & J. W. Slocum (1977), "Size, technology, environment and the structure of organizations", *Academy of Management Review*, Vol. 2, pp. 561-575.
23. Forgione, D. A. (1997), "Health care financial and quality measures: international calls for a balanced scorecard approach", *Journal of Health Care Finance*, Vol. 24, Nº 1, pp. 35-50.
24. Freidson, &. (1975), *Doctoring Together: A Study of Professional Social Control*. Chicago, IL: University of Chicago Press.
25. Galbraith, J. (1973), *Designing complex organizations*. Reading, Mass.: Addison - Wesley.
26. Galbraith, J. R. (1977), *Organization Designs*. Reading, Mass.: Addison -Wesley.
27. Gordon, L. A. & V. K. Narayanan (1984), "Management accounting systems, perceived environmental uncertainty and organization structure-an empirical investigation", *Accounting, Organizations and Society*, Vol. 9, pp. 33-47.
28. Gore, P. S. & J. B. Rotter (1963), "A personality correlate of social action", *Journal of Personality*, Vol. 31, pp. 58-64.
29. Govindarajan, V. (1988), "A contingency approach to strategy implementation at the business-unit level-integrating administrative mechanisms with strategy", *Academy of Management Journal*, Vol. 31, pp. 828-853.
30. Groot, T. (1999), "Budgetary reforms in the non-profit sector: a comparative analysis of experiences in health care and higher education in the Netherlands", *Financial Accountability & Management*, Vol. 15, Nº 3/4, pp. 353-376.
31. Gupta, A., I. J. Chen & D. Chiang (1997), "Determining organizational structure choices in advanced manufacturing technology management", *Omega International Journal of Management Science*, Vol. 25, Nº 5, pp. 511-521.
32. Gupta, A. K. & V. Govindarajan (1986), *Testing for interaction in contingency research: Conceptual and methodological issues.* Working paper Nº 181, Amos Tuck School of Business Administration, Dartmouth College, Hanover, N.H.
33. Habib, M. & B. Victor (1991), "Strategy, structure, and performance of U.S. manufacturing and service MNCs: a comparative analysis", *Strategic Management Journal*, Vol. 12, pp. 589-606.

34. Hartmann, F. G. (2000),"The appropriateness of RAPM: toward the further development of theory", *Accounting, Organizations and Society*, Vol. 25, Nº 4/5, pp. 451-482.
35. Hopwood, A. G. (1976), *Accounting and Human Behavior*, Englewood Cliffs NJ: Prentice Hall.
36. Ittner, C. D. & D. F. Larcker (1998), "Are nonfinancial measures leading indicators of financial performance? an analysis of customer satisfaction", Journal *of Accounting Research*, Vol. 36, pp. 1-35.
37. Jones, C. S. (1999), "Developing financial accountability in British acute hospitals", *Financial Accountability and Management*, Vol. 15, Nº 1, pp. 1-20.
38. Jones, C. S. & I. P. Dewing (1997), "The attitudes of NHS clinicians and medical managers towards changes in accounting controls", *Financial Accountability & Management*, Vol. 13, Nº 3, pp. 261-280.
39. Jonsson, S. & R. Solli (1993), "Accounting talk in a caring setting", *Management Accounting Research*, Vol. 4, Nº 4, pp. 301 -321.
40. Kaplan, R. S. & A. A. Atkinson (1998), *Advanced Management Accounting*. Upper Saddle River, NJ: Prentice Hall.
41. Kaplan, R. S. & D. P. Norton (1992), "The Balanced Scorecard - Measures That Drive Performance", *Harvard Business Review*, Vol. 70, Nº 1, pp. 71-79.
42. Kaplan, R. S. & D. P. Norton (1996), *The Balanced Scorecard: Translating Strategy into Action*. Boston, Massachusetts: Harvard Business School Press.
43. Lapsley, I. (1994), "Responsibility accounting revived? Market reforms and budgetary control in health care", *Management Accounting Research*, Vol. 5, Nº 3/4, pp. 337-352.
44. Lawler, &. &. (1993), "Creating the high-involvement organization", in *Organization for the Future*, J. R. Galbraith & &. &. Lawler (editors), pp. 172-193, Jossey-Bass.
45. Lawrence, P. R. & J. W. Lorsch (1967), *Organization and environment*, Bonston: Division of Research, Graduate School of Business Administration, Harvard University.
46. Lee, H., L. M. Delene, M. A. Bunda & C. Kim (2000), "Methods of measuring health-care service quality", *Journal of Business Research*, Vol. 48, Nº 3, pp. 233-246.
47. Lei, D., D. A. Hitt & J. D. Goldhar (1996), "Advanced manufacturing technology: organizational design and strategic flexibility", *Organizational Studies*, Vol. 17, Nº 3, pp. 501-524.
48. Lorsch, J. & S. Allen (1973), *Managing diversity and interdependence*, Boston: Division of Research. Graduate School of Business Administration, Harvard University.
49. March, J. G. & H. A. Simon (1958), *Organizations*, New York: Wiley.
50. McCraw, T. K. (2007), *Prophet of Innovation: Joseph Schumpeter and Creative Destruction*, Cambridge: Harvard University Press.
51. Mensah, Y. M. (2000), "Accounting issues in health care", *Journal of Accounting and Public Policy*, Vol. 19, pp. 3-7.
52. Merchant, Y. M. (1998), *Modern Management Control Systems: Text and Cases*, Upper Saddles River: Prentice Hall.
53. Miles, R. &. & C. C. Snow (1978), *Organizational Strategy, Structure and Process*, New York: McGraw-Hill.

54. Miles, M. P., J. G. Covin & M. B. Heeley. (2000), "The relationship between environmental dynamism and small firm structure, strategy, and performance", *Journal of Marketing Theory and Practice*, Vol. 8, Nº 2, pp. 63-78.
55. Miller, D. (1987), "The structural and environmental correlates of business strategy", *Strategic Management Journal*, Vol. 8, Nº 1, pp. 55-76.
56. Mitchell, T. R., C. M. Smyser & S. &. Weed (1975), "Locus of control, supervision and work satisfaction", *Academy of Management Journal*, Vol. 18, pp. 623-631.
57. Mouritsen, J. & A. Bekke (1997), "Continuity and discontinuity in accounting technology in Danish institutions", *Financial Accountability and Management*, Vol. 13, Nº 2, pp. 165-180.
58. Naman, J. L. & D. P. Slevin (1993), "Entrepreneurship and the concept of fit: a model and empirical tests", *Strategic Management Journal*, Vol. 14, Nº 2, pp. 137-153.
59. Neely, A. (1999), "The Performance Measurement Revolution: Why Now and What Next?", *International Journal of Operations and Production Management*, Vol. 19, Nº 2, pp. 205-228.
60. Neely, A., M. Gregory & K. Platts (1995), "Performance measurement system design: a literature review and research agenda", *International Journal of Operations & Production Management*, Vol. 15, Nº 4, pp. 80-116.
61. Organ, D. W. & G. N. Greene (1974), "The perceived purpose fulness of job behavior: antecedents and consequences", *Academy of Management Journal*, Vol. 17, pp. 69-78.
62. Otley, D. T. & A. Fakiolas (2000), "Reliance on accounting performance measures: deadend or new beginning?", *Accounting, Organizations and Soc*iety, Vol. 25, Nº 4/5, pp. 497-510.
63. Ouchi, W. G. (1977). "The relationship between organizational structure and organizational control", *Administrative Science Quarterly*, Vol. 22, pp. 95-113.
64. Patten Jr., T. H. (1977), *Pay: Employee Compensation and Incentive Plans*, London: Free Press.

65. Phares, &. J. (1968), "Differential utilization of information as a function of internal-external control", *Journal of Personality*, Vol. 36, pp. 649-662.
66. Preston, A. M., D. J. Cooper & R. W. Coombs (1992), "Fabricating Budgets: A Study of the Production of Management Budgeting in the National Health Service", *Accounting, Organizations and* Society, Vol.17, Nº 5/6, pp. 561-593.
67. Pines, H. A. & J. W. Julian (1972), "Effects of task and social demands on locus of control differences in information processing", *Journal of Personality*, Vol. 40, pp. 407-416.
68. Pol, &. & P. Carroll (2006). *An Introduction to Economics with Emphasis on Innovation*, Melbourne: Thomson.
69. Scholtes, P. R. (1997), "Communities as systems: Americans need to pick up where W. Edwards Deming left off", *Quality Progress*, July, pp. 49-53.

70. Schumpeter, J. (1934), *The Theory of Economic Development: An inquiry into profits, capital, credit, interest and the business cycle*, Cambridge: Harvard University Press.
71. Scott, T. W. & P. Tiessen (1999), "Performance measurement and managerial teams", *Accounting, Organizations and Society*, Vol. 24, Nº 3, pp. 263-285.

72. Sewell G. (1998), "The discipline of teams: The control of team-based industrial work through electronic and peer surveillance", *Administrative Science Quarterly*, Vol. 43, Nº 2, pp. 397–428.
73. Shortell, S. M., R. Gillies, D. A. Anderson, K. M. Erickson & J. B. Mitchell (1996), *Remaking Heath Care in America: Building Organized Delivery Systems*, San Francisco: Jossey Bass.
74. Shortell, S. M. & &. J. Zajac (1990), "Perceptual and archival measures of Miles and Snow's strategic types: a comprehensive assessment of reliability and validity", *Academy of Management Journal*, Vol. 33, December, pp. 817-832.
75. Slater, S. F. & &. M. Olson (2000), "Strategy type and performance: the influence of sales force management", *Strategic Management Journal*, Vol. 21, pp. 813-829.
76. Smith, P. (1993), "Outcome-related performance indicators and organizational control in the public sector", *British Journal of Management*, Vol. 4, Nº 3, pp. 135-151.
77. Snow, C. C. & L. G. Hrebiniak (1980), "Strategy, distinctive competence and organizational performance", *Administrative Science Quarterly*, Vol. 25, June, pp. 317-336.
78. Solomons, D. (1965), *Divisional Performance: Measurement and C*ontrol , Homewood: Irwin.
79. Spector, P. &. (1982), "Behavior in organizations as a function of employee's locus of control", *Psychological Bulletin*, Vol. 91, pp. 482-497.
80. Stern, J. M., J. Shielye & I. Ross (2004), *The EVA Challenge: Implementing Value-added Change in an Organization*, New York: John Wiley and Sons Inc.
81. Rotter, J. B. (1954), *Social Learning and Clinical Psychology*, New York: Prentice-Hall.
82. Rumelt, R. P. (1974), *Strategy, Structure, and Economic Performance*, Boston: Division of Research, Graduate School of Business Administration, Harvard University.
83. Thompson, J. D. (1967), *Organizations in action*, New York: McGraw Hill.
84. Tushman, M. L. & D. A. Nadler, (1978), "Information processing as an integrating concept in organizational design", *Academy of Management Review*, Vol. 3, pp. 613-624.
85. Vancil, R. F. & L. &. Buddrus (1979), *Decentralization: Managerial Ambiguity By Design*, Homewood: Irwin.
86. Vancil, R. F. (1980), *Decentralization: Managerial ambiguity by design*, New York: Financial Executives Research Foundation.
87. Watkins, A. L. (2000), "Hospital financial ratio classification patterns revisited: upon considering nonfinancial information", *Journal of Accounting and Public Policy*, Vol. 19, Nº 1, pp. 73 -95.
88. Wolk, S. & J. DuCette (1974), "Intentional performance and incidental learning as a function of personality and task dimensions", *Journal of Personality and Social Psychology*, Vol. 29, pp. 90-101.
89. Young, D. & R. Saltman (1985), *The Hospital Power Equilibrium – Physician, Behavior and Cost Control*, Baltimore: John Hopkins University Press.
90. Zimmerman, J. (1997), *Accounting for Decision Making and Control*, Boston: Irwin/McGraw-Hill.

THE CERTIFICATION PROCESS OF DOURO VALLEY WINES: QUALITY DETERMINANTS FOR QUALITY WINES

Sara Rodrigues
IVDP, Instituto dos Vinhos do Douro e do Porto, Peso da Régua, Porto, Portugal
sarajmrodrigues@gmail.com

Humberto Ribeiro
GOVCOPP; ESTGA, University of Aveiro, Portugal
humberto@alumni.dmu.ac.uk

Sandra Raquel Alves
CIC.DIGITAL; Polytechnic Institute of Leiria; ESTGF, Polytechnic of Porto, Portugal
raquel.alves.pt@gmail.com

Claudia Miranda Veloso
UNIAG; Institute Polytechnic of Bragança
University of Aveiro, Portugal
cmv@ua.pt

ABSTRACT

This research has the purpose to highlight the importance of the certification of Douro's and Port's wine processes, within the Douro's Demarcated Region, in order to ensure the quality of the wine production. With this approach, some light is shed on the role played by the certifier and regulator entity, the Douro and Port Wines Institute (IVDP - Instituto dos Vinhos do Douro e Porto, IP). The objective of this paper is to study the process of wine certification, in the scope of a quality framework, examining the outcome of such procedure, as wines certification may be approved, or disapproved, and even may get different complementary designations, following the results obtained whether in sensorial, or in laboratorial analysis. The results obtained allow to conclude that the number of processes of certification submitted is rising, as well as the number of wines approved, and there has been an increase in the overall quality of the product, showed by the better notations in tasting obtained (sensorial analysis).

Using an OLS model, it was possible to test and find that a number of variables, such as factors intrinsic to wine, the type of wine, or the complementary designation, as well as the certification process itself, can contribute significantly to the overall quality and Certification of Douro wines, thus confirming the our research hypothesis.

Keywords: *Douro wines, Quality determinants, Quality management, Sensorial and laboratorial analysis, Wine Certification*

1. INTRODUCTION

Despite not being a very large country in area, Portugal presents a wide diversity of different types of territories and climates. Very interestingly is the fact of being a Mediterranean country – even if not bathed by Mediterranean Sea, and simultaneously an Atlantic country, as its shores are exclusively bathed by the Atlantic Ocean. This special blend, together with diverse territorial particularities, offer unique conditions for wine production.

Of particular interest is the wine region of the Douro, also known as the "Alto Douro" or the "Wine Country" (Almeida and Laureano, 2007). This is a unique area, at worldwide level,

marked and influenced by Douro river, which gives the name to region. Born in Spain, Douro river crosses the North of Portugal, from Barca D'Alva to Porto city, where it meets the Atlantic Ocean.

The Douro Demarcated Region (RDD), which covers a total area of about 250,000 ha, is located in the Northeast region of Portugal, in the Douro river basin, surrounded by mountains that give it particular climatic and climatic characteristics. RDD, or Alto Douro, is the oldest demarcated and regulated wine region in the world, since its origins date back to 1756 (Alto Douro Pombalino), the year in which Sebastião José de Carvalho e Melo, minister of King D. Jose I, established the General Agriculture of the Vineyards of the Alto Douro, with its headquarters in Oporto. Among its first functions, this company had the demarcation of Alto Douro and the regulation of the "boarding wine", "Douro wine" or "Port wine", dating back to the 17th century. From that time on, the Pombaline landmarks that marked the area of the vineyard Douro still exist. Recently, in 2001, the Alto Douro region, along the Douro River, was classified by UNESCO as a World Heritage Site.

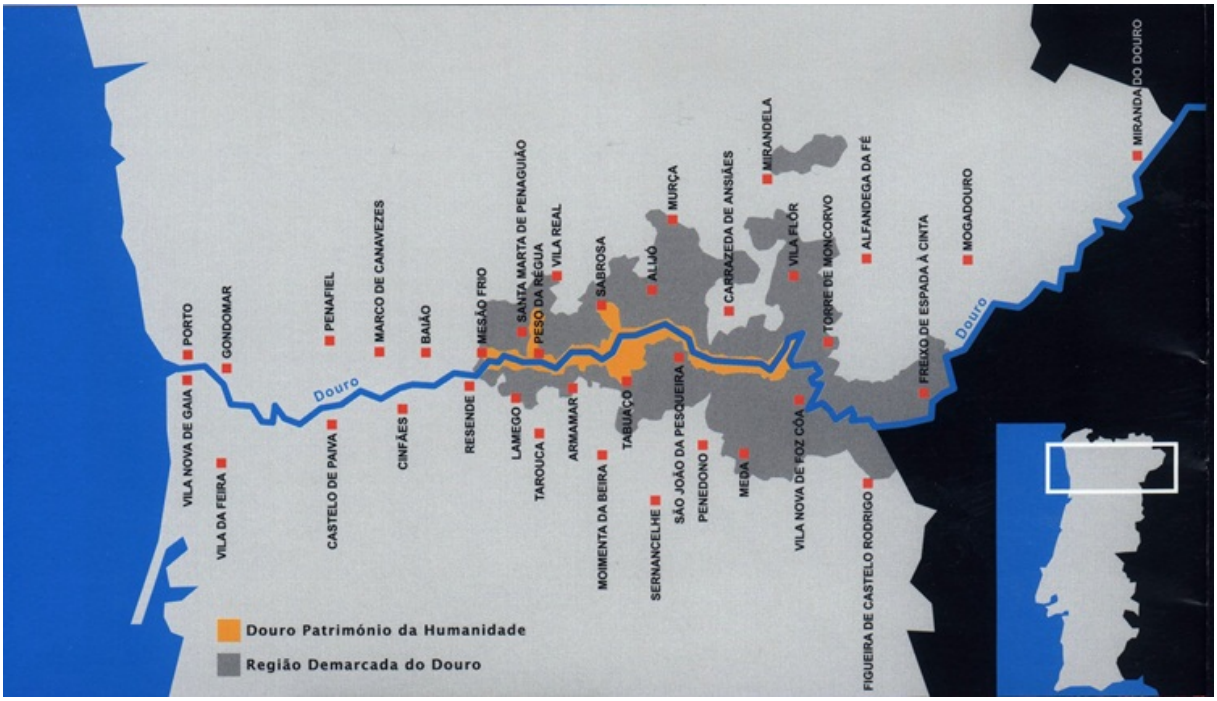


Figure 1: Douro Demarcated Region map (source: Tourism of Portugal)

Figure 1, above, shows the Douro Demarcated Region, being the wine producing area, located within the controlled region, highlighted in grey and orange. Highlighted in orange, is the area classified by UNESCO as a World Heritage Site.

The heritage of the Douro region is vast, ranging from Roman remains of the vineyard culture to beautiful farms and manors of the region's producers. It is also a region of significant historical value given that Port Wine, one of the main and most recognized Portuguese products, gives this region a cultural and economic richness (its weight in Portuguese wine exports with Denomination of Origin (DO) reaches values of about 80%) that we cannot ignore.

Douro wines were considered for many years a minor product, in other words, a by-product, in front of the all-powerful Port wine, of old traditions and noble interests. For years, its main destination was the burning for the production of brandy for the manufacture of Port. At the moment there is a reversal of this idea. In fact, Douro wines have gradually and incisively occupied a prominent place with national and international importance for the quality they

present. The certifying and regulating body for the quality of Denominations of Origin in the RDD is the Douro and Porto Institute of Wines, IP (IVDP - Instituto dos Vinhos do Douro e Porto). This work aims to demonstrate the importance of Douro wines, thus analyzing the process of certification of wines with Denomination of Origin Douro and Geographical Indication Duriense.

2. CHARACTERIZATION OF THE DEMARCATED REGION OF THE DOURO

The Douro landscape is the result of the interaction between the physical environment and the societies that have been working it (Pedrosa, et al., 2004). The natural characteristics of the territory condition the different types of soil use which, in turn, influence the configuration of the material properties. But port wine is undoubtedly one of the most humanized wine products, that is, where the intervention of man is most evident and necessary. From the arrangement and planting to the accompaniment and stage of the wine (Rosas, 1990).

The characteristics that have the greatest weight for the production of the vine and wine, are undoubtedly climatological and edaphic (geological, pedological), but only with anthropic work can be translated into the aptitude of the region. The demarcated region of the Douro (RDD), geologically, is almost entirely composed of the Complex-Xisto-Grauváquico, ante-Ordovícico of the Douro group, that dates predominantly of the Cambrian. The great majority of the authors consider that the wines of the lands of schist origin are of better quality than those coming from the granitic soils (Carvalho, 1948), and the grapes planted in granite can not be compared with those grown in the shale, Both in terms of quantity and quality of wine.

The climate is undoubtedly one of the most peculiar characteristics of RDD, which distinguishes it from its surrounding areas. As for precipitation, the observed values do not exceed the 1000mm (mean annual precipitation). In some areas, they do not exceed 300 mm (p.a.m), only comparable in Portugal with the pluviometric regime of the island of Faro (Daveau, 1977). As for the average number of days with precipitation, the values obtained for RDD do not exceed 60 days, and according to Daveau (1977) it can be compared to the southernmost territory of mainland Portugal. The pluviometric values obtained are explained by the blockade of the sea currents caused by the mountainous complex Montemuro-Marão-Alvão and by the sometimes deep insertion of the Douro river valley. The precipitation differences between the valley shoals (300mm) and the ridges of the mountainous complex (2500mm) are disparate and evident. The mean values of precipitation, obtained from upstream downstream, also undergo an evident change, ranging from 381mm in Barca d`Alva to 1048mm 4m in Mesão Frio, something which well represents the action of continentally.

The average annual temperatures of the stations located in the RDD, exceed 2 ° C to 3 ° C the meteorological stations that are in its periphery. In terms of maximum values the discrepancy can reach 8 ° C of difference, as happens between the station of Bigorne and Pinhão, while in the minimum the greatest disparity is between Pinhão and Miranda do Douro (5.6 ° C). According to Abreu (1991) during the ripening period, daily temperature variations should be small to cause a good ripening of the grapes, necessary for the production of Port wine.

Illustration follows on the next page

Illustration 1: The unique vineyards landscape of Douro region (source: Douro Valley)

Both the pluviometric as well as the thermal aspects in its arrangement are intrinsically related to the morphometric factors, especially the altitude. Thus, the hottest locations, located at the bottom of the valleys, are those that are more suitable for wine production.
The morphology of the RDD is characterized by deep, generally adapted and embedded valleys, which show great influence on temperatures and precipitation. But the most important factor that comes from the deep valleys is the orientation of the slopes and consequent exposure to solar radiation, which can be considered one of the most important determinants for the quality of wine and must. The orientation to S and SW, which is more sunny, generally presents the best maturation conditions (Santos, 1961), except in situations where there is a strong insolation, a very scarce rainfall, which can cause water stress in the vineyard (Species well adapted to dry-climatic conditions). Another morphological feature is not the slope, not the relationship between this and the climatic characteristics, but the possible cultivation techniques to use, according to the slope. In RDD, the majority of the vineyards installed in this region are in lands with slope between 30% and 70% (Félix, 1984). The altitude and the shelter to the winds, although to a lesser degree, also influence the quality of the wines and the varieties to choose.
As for the soil characteristics, RDD soils are poor and poorly developed (thin thickness), and the man has since early contributed to their formation by disintegrating the mother rock, preparing the soil, usually by levels (Abreu, 1991). For this reason, RDD soils can be generally classified as "antroposols" (soils of anthropic origin). As for the texture, the predominant soils are French-sandy to French-loamy. A predominance of the former is evident. Essentially this is the set of characteristics, which since 1756 allowed the delimitation of RDD.

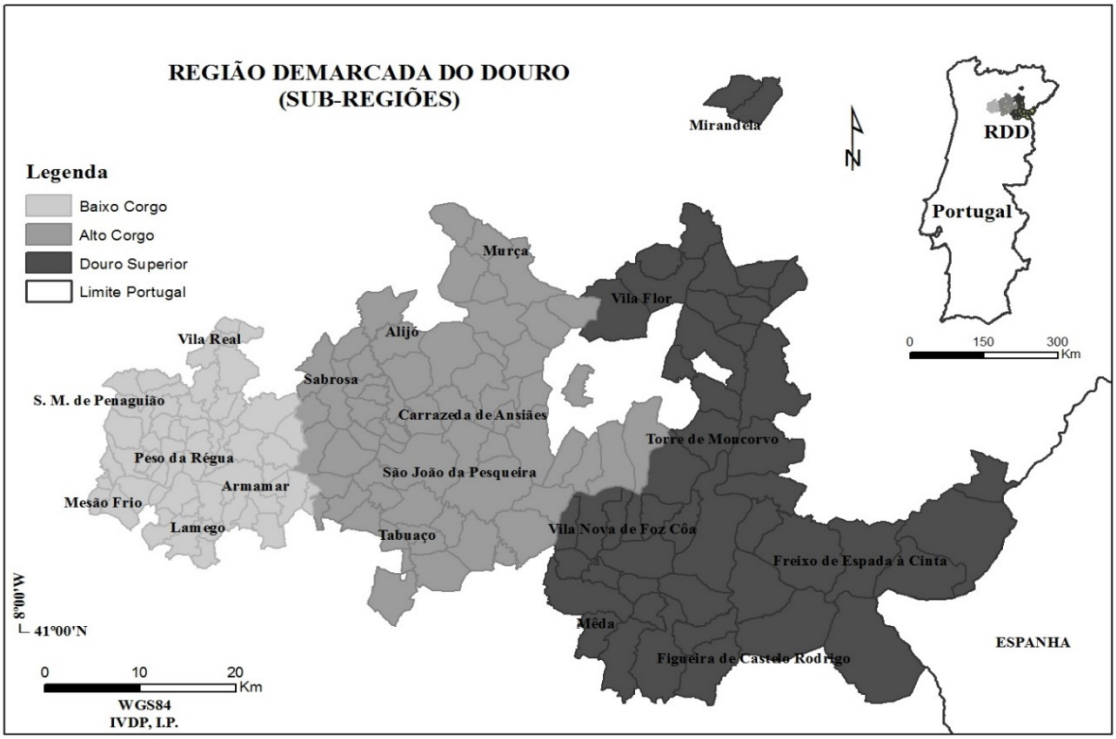


Figure 2: RDD Sub-Regions map (source: João Belo)

The vineyard territory destined to the production of port wine coincides with the geographical area where Douro Denomination of Origin wines can be produced, such as DO Douro, DO Espumante, DO Moscatel and Déu Geographical Indication (Duriense IG) DL 254/1998 of 11 Of August and Decree-Law no. 173/2009.

The Douro is traditionally divided into three sub-regions (vid. Figure 2): Baixo Corgo, Cima Corgo and Douro Superior. The distribution of vines is not uniform: (IVDP, IP 2010)

- Baixo-Corgo - with approximately 32.2% of the area occupied by vineyards, is the entire right bank of the Douro River, from Barqueiros to Rio Corgo (Régua). On the left bank, from the parish of Barrô to the Temi-Lobos River, near the village of Armamar.
- Cima-Corgo - with approximately 22%, relies on the previous one and goes to the meridian that passes in Cachão da Valeira;
- The Upper Douro - with approximately 9.3%, relies on the former and goes to the Spanish border.

Only 18.2% of the total area of the Demarcated Region is planted with vineyards, as shown in the table below.

Table 1: RDD Sub-Regions Characterization (Source: IVDP, 2010)

Sub-Region	Total area (ha)	%	Vineyard area (ha)	%
Baixo Corgo	45.000	18	14.501	32,2
Cima Corgo	95.000	38	20.915	22
Douro Superior	110.000	44	10.197	9,3
Total	**250.000**		**45.613**	**18,2**

Breeds cultivated in the region are not famous for their high production, yet they have a secular history, since some castes come from the time of the Order of Cister (Middle Ages, Esteves, 2008). In the second half of the twentieth century, the study and analysis of planted grape varieties began and it was concluded that the best grape varieties for Douro and Porto wine production are: Touriga Nacional, Touriga Franca, Tinta Barroca and Tinta Roriz and Tinto Cão. The new farms of the region cultivate essentially these varieties, but also others very important and with much expression in the region, as for example, the breeds Trincadeira and Sousão. The production of white wines is essentially sustained by the plantation of grape varieties such as Malvasia Fina, Gouveio, Rabigato and Viosinho. For the production of Muscat, the Moscatel Galego variety is planted.

3. DOURO AND PORTO INSTITUTE OF WINES (IVDP) MISSION AND WINES CHARACTERIZATION

The creation of the Alto Douro Vineyard Company in 1756, on the initiative of Sebastião José de Carvalho e Melo, was the first step towards the emergence of what would be the first demarcated and regulated wine region in the world (Guichard, et al., 2003).

The Oporto Wine Institute, a state oversight body, was created in 1933. In 2003, as a result of the merger with the Interprofessional Commission of the RDD (CIRDD), it adopted its current designation of IVDP. It will be with the Organic Law approved by Decree - Law no. 47/2007, of February 27 that is to be designated IVDP, IP, public institute of interprofessional nature, integrated in the indirect administration of the State, whose mission is to defend, control, Certify and promote the denominations of origin "Douro" and "Porto" as well as the Geographical Indication Duriense.

In detail, in the exercise of the mission, it is incumbent upon the IVDP, IP (IVDP, 2010):

- •Propose strategic orientation and implement the wine policy for the Demarcated Douro Region (RDD), namely ensuring the knowledge of the whole range and structure of production and trade, including export, and the actions delegated to it by the Institute Of the Vine and Wine, IP;
- • Promote the convergence of production and trade interests in the defense of the general interest of RDD, by disciplining, controlling and supervising the production and marketing of wines produced in the RDD, ensuring the file of vineyards in this region, controlling the census of wine producers , Making the appropriate checks for this purpose and determining the necessary corrections;
- • Control, promote and defend the designations of origin and geographical indication of the DRD, as well as the other wines and wine products produced, produced or transiting in the RDD;
- • Instruct infringement proceedings and apply sanctions for which it has jurisdiction to infringements detected by its services or by other entities;
- • Stimulate the adoption of best practices in the field of wine-growing and technological development (IVDP 2010).

3.1 Douro wines characterization

The Douro wine region was demarcated and regulated more than two centuries ago, with special attention to the discipline, defense and promotion of generous wine, which was already exported to several markets under the name of Port Wine (Salvador, 2007). Ordinance no. 1080/82, of 17 November, recognized and regulated the so-called "Douro wine denomination", reserved for typical regional, white and red wines traditionally produced in the Douro Demarcated Region

The publication of the framework law on wine-growing regions, Law no. 8/85 of 4 June, paved the way for a necessary adaptation of our legislation to Community legislation, in

particular when defining the scope of the statutes of the demarcated regions, those of regional wine commissions.
Following that diploma, Decree-Law no. 166/86, of June 26, approved the Statute of the Port Wine Denomination of Origin.
On August 11, 1998, Decree-Law no. 254/98 updates the designations of origin "Porto" and "Douro" that can be used for wines and wine products produced in the Douro Demarcated Region, taking into account the respective delimitation and individualized definition, given the possibility of producing more than one type of wine in the same vineyard.
The regulation of the names "Porto" and "Douro" and the geographical indication "Duriense" was dispersed by multiple ordinances and decrees. It was necessary to systematize it in a coherent way, in a single decree-law, making the necessary updates imposed by an increasingly competitive and global market.
It will be the DL nº 173 of August 2009 that revoking previous Ordinances and Decrees (some of the 1920s) reformulates the denominations of origin indicated and updates by adding the statutes of the Duriense Geographical Indication (Ministry of Agriculture, Commerce and Fisheries , 2009).
Thus, it is recognized:
-The status of the designations of origin and geographical indications of the RDD, the "Porto" and "Douro" Designation of Origin (DO), as well as the "Duriense" GI, which may only be used in wines and wine products produced in the Region Demarcated and cumulatively comply with the applicable wine regulations;
- DO Oporto may be used for generous wine in the category of liqueur wine and other RDD wine products;
- Douro wine can be used for white, red and rosé wines in tranquil wine, sparkling wine and liqueur wine called "Moscatel do Douro" and other RDD wine products;
- IG "Duriense" can be used to identify any category of white, red and rosé wines.
In DO Douro and IG Duriense wines by their color have different alcohol content. In IG Duriense, the minimum alcoholic strength should be 10% vol., Wines with white and rosé DO Douro should be 10.5% vol. And in reds 11% vol. For Moscatel do Douro it must have a minimum actual alcoholic strength of 16,5% vol. And a maximum of 22.0% vol (Ministry of Agriculture, Trade and Fisheries, 2009).
The wines with respect to their color also exhibit some relevant characteristics at the sensorial level (Esteves, 2008):
-Tinto - These are wines made from varieties such as Touriga Nacional, Touriga Franca, Tinta Roriz, Tinta Barroca and Tinto Cão. The vast majority of the wines come from a batch of various grape varieties with a unique complexity and richness A characteristic profile of the Douro. They have a ruby color and aromas of red fruits like raspberries and strawberries, which can be complemented by floral and wood notes. They have medium body and balanced astringency, this for young wines. In new wines, notes of black fruits, chocolate, balsamic, violet and wood are common, being wines of great structure and with persistent tannins; -Branco - Dry wines are produced by stocking various castes such as Malvasia Fina, Viosinho, Gouveio and Rabigato. Young wines have a pale color, with refreshing fruit aromas (citrus and other tree fruits) and floral, in the mouth are balanced showing their youth. Wines of guard, have good aromatic intensity and good complexity and generally ferment or stagger in wood, presenting in these cases a golden color, toasted aroma and tropical fruit. On the palate they are full and persistent; -Rosado - These wines produced from a light maceration of red grapes, present a beautiful rosy color and exuberant young aromas of raspberry, cherry and sweet. In the mouth, they are enthusiastic about its softness, sweetness and acidity. These wines should be consumed while young.

3.2 The wine certification process

The certification of the wines requires the consecration of a process of sensorial appreciation and a laboratorial. These two processes simultaneously have to obtain an "Approved" result, a necessary condition to start the registration process.

The Laboratory of the IVDP, IP, responsible for one of the processes, is endowed with the most modern means of analysis being formed by a suitably trained and specialized technical staff. This laboratory was certified by the NP EN ISO / IEC 17025 standard in compliance with strict qualitative requirements (IVDP Regulation, IP nº.82 / 2010). It is a technical service that is part of the IVDP, IP assignments. It has the most sophisticated equipment to respond with quality and efficiency to the most diverse needs, in the field of food safety and the characterization of wines.

The IVDP, IP proves the wines suitable for DO Douro and Porto and IG Duriense and was the first Chamber of Wine tasters in Portugal, accredited by the norm NP EN ISO / IEC 17025 (recognition of technical competence by entity independent). It is composed of tasters (minimum 3, maximum 7) who belong to the structure of the IVDP.IP, should decide, as regards the organoleptic characteristics, on the quality of the wines likely to obtain the DO Douro or IG Duriense. This assessment imposes a professional chamber of tasters and therefore has its own regulation (Regulation No.82 / 2010).

However, if the deliberation of the Chamber of Proofers is the disapproval of a batch, the operators may also request a review by means of recourse to the Consultative Council of Takers, which has an exclusive interprofessional composition (members representing trade and production). This Advisory Board has the power to rule on appeals from the deliberations of the Chamber of Provedors (Regulation 82/2010), only at the organoleptic level, deciding on the quality of the wines presented to it. Assumes that the lot is approved at the laboratory level.

The approval of registers with indication of traditional terms and / or complementary designations must obtain, in the sensorial analysis (Chamber of tasters), the minimum notations referred to in Regulation no. 242/2010 of 15 March (establishes the applicable regime The protection and presentation of designations of origin and geographical indications of the RDD, disciplining the respective traditional terms, complementary names and stages of wines).

4. RESEARCH METHODOLOGY AND MODEL

In this work the methodology starts with the formulation of research hypothesis, followed by the exploration of the problem analysis, the construction of the analysis model, observation, analysis of information and conclusions. The study of this work aims to analyze the main determinants that are involved in the process of Certification of wines with Denomination of Origin Douro and Geographical Indication Duriense, under the responsibility of IVDP, IP. In this way, the following question is asked: *Can the process of certification of a Douro wine be determined by a set of specific factors that are possibly explanatory?* In order to answer this question, it was necessary to have an interpretative research and analysis of the information contained in the IVDP, IP database, as well as a collection of legislation through which this certification process is governed.

Based on the collected elements, the following hypothesis was formulated, to be tested in the investigation shown in this paper:

The final result of the process of certification of a Douro wine can be determined by a set of factors intrinsic to the wine, as well as by the certification process itself.

In order to know and understand the certification process, it was necessary to collect data on the processes that were certified in the period between mid-2000's and 2010's, in the

expectation of being able to test the above hypothesis, which is expected, under conditions can be confirmed. A sample characterization was performed, and a Multiple Linear Regression Analysis Model was constructed, with a description of the variables and their interpretation. In this way, the Regression Model applied to the universe of number of processes received in this period by type of product is first known and then only for the processes for the purpose of "Registration" was the analysis of the approved and disapproved processes, as well as the Registration procedures approved by the type of complementary designation requested by the operator and lastly the detailed analysis of the failed registration procedures.
This study also included the discussion of the analysis of the percentage of disapprovals throughout the sample and the reason for reprobation in the most prevalent sensory analysis.

4.1 Sample
The sample corresponds to all the processes submitted to IVDP, IP from the period between mid-2000's and 2010's and is grouped based on the four variables corresponding to four products in the region: DO Douro (code 04), DO Moscatel (DO Code 07), IG Duriense (code 06) and others (codes 05, 09,10,12,91 and 94). DO Douro wines accounted for the vast majority in the sample: 83.5%, while DO Moscatel totalled 3.1%, IG Duriense, 10%, and others, some 3.4%. The whole sample comprises a total of 16901 processes.

4.2 Variables
The dependent variable, Global result of the process, is a categorical variable, which will assume the value 1, when the overall evaluation of the registration process results in approval, the value 0 when the result is disapproved and the value 2 when it respects the other results.
In the independent or explanatory variables, the process year is a time variable that explains the year in which the process entered the IVDP, IP, assuming the value 1 for the year 2004, the value 2 for the year 2005 and so on. The year of process may have some influence on the overall result, due to some trend that occurs a year in the global appreciation of wines, or the constitution of the analysis panels.
The color of the wine is a variable that assumes the value 1 when the wine is white, the value 2 when it is red and the value 3 when it is pink. The different shades of the wine may also influence the overall result of the submission, being that in general there is a predominance of red wines, at least in the number of submitted processes, also perceiving their superiority in terms of quality.
The product is a variable that can have as common codes 4 for DO Douro, 6 for IG Duriense and 7 for DO Muscat, as other codes in one up to code 94. The product type is a variable that such as Product may assume several codes, such as 7 for "quinta" (farm, villa with cellar) wines, 10 for wines with a harvest date, 11 for wines with no harvest date among others. The product may influence because there are several types in which the notations to achieve the overall result are also different.
The complementary designation is a qualitative variable in grouping the test notation in levels, assuming code 93 for level 1, code 94 for level 2 and code 95 for level 3. In this variable is implied the quality of each wine. By means of this notation the overall result will be influenced or not.
The purpose is a variable defined by the purpose of each process, resulting in the most common codes as 1 for registration purpose, 3 for purpose complement registration, among other codes up to 23. In this case the purpose is an important variable.

The test and laboratory results are variables that assume code 1 for approved results, code 0 for failed results and value 2 for other results. In this case the variables are directly related to the overall result, since through these results, the final result will be significant or not.
The following acronyms were used as follows in Table 2, below.

Table 2: Variables description

Code	Description
• ANOPCS	Process Year
• CORCOD	Color of wine
• PRDCOD	Product
• TPOCOD	Wine Type
• CMPCOD	Supplementary designation
• FNDCOD	Purpose
• RSLPRV	Test result
• RSLANL	Laboratory result

4.3 The research model (OLS)

The multiple linear regression model adopted in this research depends on the final result of the process of submitting a particular wine for certification to the IVDP, IP of a broad set of factors, which are summarized in the model below:

$$Global\ Result_i = Year_i + Color_i + Product_i + Wine\ Type_i + Complementary\ Designation_i + Purpose_i + Result\ Laboratory_i + Test\ Result_i + e_i$$

5. MODEL DESCRIPTIVES AND RESULTS

5.1 Descriptive statistics

A brief statistical description of the variables used in the regression model is given in Table 3.

Table 3: Descriptive statistics

	No.	Minimum	Maximum	Average	Std. Variation	Variation
PRDCOD	16901	4	94	4,82	6,542	42,800
FNDCOD	16901	1	23	4,60	5,511	30,368
TPOCOD	16901	0	94	9,85	1,926	3,710
CORCOD	16901	0	3	1,80	,495	,245
CMPCOD	16901	0	98	89,99	17,428	303,726
RSLANL	16901	0	2	1,11	,359	,129
RSLPRV	16901	0	2	1,04	,539	,291

5.2 Model results and statistics

Table 4 presents the results of significance testing values for the model variables.

able 4: Coefficients of the regression model

Variables	Non-Std. Coefficients		Standardized. Coefficients	*t* Test	p-value	Tolerance	VIF
	β	Std. Error	Beta				
Constant	,028	,021		1,345	,179**		
ANOPCS	,002	,001	,010	2,274	,023**	,983	1,017
CORCOD	-,025	,004	-,026	-5,942	,000***	,991	1,009
PRDCOD	,000	,000	-,003	-,753	,452	,772	1,296
TPOCOD	,005	,001	,019	4,202	,000***	,990	1,010
CMPCOD	-,001	,000	-,049	-10,406	,000***	,987	1,013
FNDCOD	-,003	,000	-,031	-6,111	,000***	,855	1,169
RSLPRV	,642	,004	,741	161,236	,000***	,779	1,284
RSLANL	,337	,006	,259	51,980	,000***	,916	1,092

** Variable significant at the 95% level
*** Variable significant at the 99% level

In the regression model almost all variables are statistically significant, in the 95% confidence interval, with the exception of PRDCOD. Even the majority of the variables are significant at the 99% level. Thus, it is concluded that the factors intrinsic to wine, CORCOD, TPOCOD and CMPCOD, as well as those of the certification process, ANOPCS and FNDCOD, contribute significantly to the overall result of the Douro wine certification process, thus answering the research question in the affirmative way, as well as confirming the research hypothesis formulated in this paper.
In addition, it can also be observed that the control variables, RLLPRV and RSLANL are also statistically significant, which was expected since they are related to the dependent variable. As mentioned above, the only variable that is not significant is PRDCOD, so it is concluded that the "product" is not relevant to obtain the overall result.
The following two tables present some statistics referring to the validation of the regression model used.

Table 5: Model fitness

R	R^2	Adjusted-R^2	Estimated Std. Error	Durbin-Watson
,820[a]	,673	,673	,267	1,596

Although the study is more focused on the identification and capture of possibly significant variables for the determination of the certification process, also the value of the adjusted R-squared obtained cannot be devalued, since 67.3% can be considered a high value of adjustment of the model, given the large number of observations used. The Model and potential changes in the Model do not violate the statistical assumptions, as well as the Durbin-Watson statistic with the approximate value of 1.6, is also close to the reference value for the statistic that is 2.

Table 6: Variance analysis

Model	Square Sun	*df*	Sqr. Mean Error	F	p-value
Regression	2480,431	8	310,054	4349,51	,000[a]
Residuals	1204,141	16892	,071		
Total	3684,571	16900			

As can be observed from Table 6, which refers to analysis of variance, the regression model is statistically significant at 99%, appearing to be well specified and presenting no problems with the dispersion of the residuals, which distribution is likely to be normal given the high size of the sample, which makes the distribution tend to be normal.

Table 7: Pearson correlation matrix

	RSLGLB	ANOPCS	PRDCOD	FNDCOD	TPOCOD	CORCOD	CMPCOD	RSLANL	RSLPRV
RSLGLB		,042	,015	,254	,032	-,032	-,290	,344	,777
ANOPCS	,000	.	,001	,068	-,025	-,045	-,076	-,027	,050
PRDCOD	,024	,468		,013	,015	-,090	,007	-,002	,023
FNDCOD	,000	,000	,048	.	,026	,001	-,255	,429	,215
TPOCOD	,000	,000	,026	,000		-,039	,069	,015	,017
CORCOD	,000	,000	,000	,462	,000		-,005	,032	-,018
CMPCOD	,000	,000	,166	,000	,000	,275	.	-,282	-,237
RSLANL	,000	,000	,379	,000	,029	,000	,000	.	,114
RSLPRV	,000	,000	,001	,000	,012	,010	,000	,000	

In Table 7, the upper diagonal are the values of the correlations and in the lower diagonal are the respective values of evidence. No non-expected problematic correlation values detected.

6. RESULTS DISCUSSION

This section presents additional quantitative and qualitative information regarding the certification process that may help to understand the results obtained in the linear regression model.

6.1 Evolution of processes by product

In a total of 16,901 registered cases, for the various purposes, in this certification process, the product that stands out most is DO Douro, followed by IG Duriense, but in a very different proportion. The DO Douro represents 83.48% of the total number of processes, while the IG Duriense only represents 10.01%, the Moscatel DO 3.10% and the remaining products occupy 3.41%. We can also see a positive evolution over the years. The number of processes for analysis increases every year.

6.2 Approved and disapproved processes

The proportion of wines approved accounted for 84.98% is much higher than the wines with 15.02% disapproved. In disapproved wines, the overwhelming majority is in sensory analysis (proof). Of the wines that have been approved and which subsequently gives rise to a registration for the possible commercialization of wines, we highlight the three most common complementary designations with the Level 1, Level 2 and Level 3 qualitative levels. These complementary designations are evaluated in the sensorial analysis.

This stratification of wines in three levels or levels of quality, which only had implications since 2006 (Regulation No. 48/2006), aimed to aggregate and distinguish the different quality references that are regulated as is the case of Mentions "Reserve", "Great Reserve", "Great Choice", "Special Reserve", "Selected Harvest".

6.3 Wines with Supplementary Designation

The analysis is done for all products. We can say that certified wines are mostly approved with Level 1 Complementary Designation (63.19%), and Level 2 is gradually increasing (28.87%). Level 3 holds values well below these two levels (7.94%). This is justified by the fact that in the sensory analysis the criterion of approval for Level 3 is the highest. Hence the quantity of wines also being lower. Associated with this level of quality, there is usually also a high market price.

Reprobation in both laboratory analysis and sensory analysis gives rise to a failed process, regardless of whether it is in only one of them.

6.4 Analysis of disapproved processes

The disapprovals of the wines are mostly in the sensory analysis. The percentage of these reprobations, which is 95.64%, contrasts with the disapprovals in the laboratory analysis, 4.36%. The percentage of wine disapproved in the competition has increased over the years, with the exception of the year 2008 and 2009, when there was a decrease compared to 2007. In 2010 there is again an increase in the number of disapproved wines and the trend will be towards increase in 2011. These variations may be related to the average quality of the crops and the time at which they are submitted for approval. For example. 2009 was the year of approval of many wines from the 2007 harvest, which was considered one of the best harvests of the decade and this quality was reflected in the decrease of the % of the disapprovals. On the other hand, the increase in disapprovals that have been gradually verified may have to do with the sector's intention to recommend to the certifying entity a greater requirement on the criteria for wine approval. In the sensorial analysis the reprobation can be four reasons:

• For lack of clarity - the wine is cloudy;

• Lack of quality for the Denomination of Origin or Geographical Indication - when the wine, although not attributed a predominant defect, does not reach the minimum rating for the requested product; Good notation for Douro wines and Quality Notation for wines IG Duriense; (Regulation 242/2010). The wine does not have the minimum quality in relation to the organoleptic characteristics;

• And because of a defect - when there is a defective aroma and flavor predominating in the organoleptic characteristics of the wine and overlapping its quality; imperfection; odors and flavors that are foreign to the product;

• Age - when the characteristics of the wine do not match the indicated age.

The defects that are associated to the sensorial analysis can be several as shown in the table:

In this study, the most obvious reason for disapproval is the lack of minimum required quality, which reaches 60.67% of the reprobated processes.
Then, with 18.15%, the oxidized defect appears, with the reduced defect failing 8.97%, with volatile phenols failing 6.00% and with failing "acescente" failing 2.24%. These are the most significant reasons for disapproval.

7. CONCLUSION

This study aimed to determine the essential determinants in the DO Douro and IG Duriense wine certification process. The research also sought to highlight the importance of IVDP, IP in this process. It was pointed out that the region famous for the Port Wine product, Douro Valley, which is subject to numerous academic, statistical and market analysis studies, has other products, than simply Port wine, that are beginning to emerge and that it is something important to research in further investigations. The results of this research strand are visible in the results inferred above, allowing to conclude that the number of processes for the certification of DO Douro and IG Duriense wines, which enter the IVDP, IP services, has increased over the years, particularly in the case of the product DO Douro. The certification process for registration, results in a high rate of approved processes, 84.98%. The notation (test classification), with 63.19%, of all processes being attributed the "Good" rating, indicates that the entities certify and place on the market a greater quantity of wines with a less demanding notation. In fact, because of the requirements of market competition and the fact that they are usually larger lots, it is the option of operators to put good quality products, but at a lower price. Wines with higher quality levels require a longer stage and winemaking techniques are more accurate. Production techniques also have higher costs, as a result of, among other things, selection of grapes required, long stages in wood and use of techniques different from those used in high volume lots. We can also conclude that disapprovals occur mainly at the sensory level. This reality is due to the fact that, in the physicochemical, or laboratory analysis, the economic agents can control the process of determining results by means of own or private equipment properly calibrated and similar to those existing in the certification body, thus avoiding that they have submit the approval wines. Regarding sensory analysis, the process is more difficult to control, mainly due to the complexity of the test and due to the fact that it is not easy to reproduce, or replace, a panel composed of 5-7 trained testers with homogeneous sensitivities and limits of perception (belonging to the Chamber of Testers) to evaluate the quality of the wines. In the development of this research, some limitations were faced, namely: although the sample size is very significant, the number of years considered could be eventually extended. In addition, the fact that the study is limited to a specific region and institution can also be considered as restrictive. Nonetheless, it was possible to test the hypothesis formulated, and it was concluded almost all variables are statistically significant at the 95% confidence interval, with the exception of the product. Moreover, the majority of the variables are significant even at the 99% level. It is thus possible to conclude that both the factors intrinsic to wine, the color of wine, the type of wine and the complementary designation, as well as the certification process itself, the year of the process, and the purpose, contribute significantly to the overall Certification of Douro wines, thus responding affirmatively to the question of departure, as well as confirming the hypothesis of investigation formulated in this paper.

ACKNOWLEDGEMENT: *This work was financially supported by the research unit on Governance, Competitiveness and Public Policy (project POCI-01-0145-FEDER-006939), funded by FEDER funds through COMPETE2020 - Programa Operacional Competitividade & Internacionalização (POCI) – and by national funds through FCT - Fundação para a Ciência & a Tecnologia.*

LITERATURE:

1. Abreu, N., M. C.(1991). *Quelques notes sur la technique de production du vin du Porto, ADVID*, Peso da Régua.
2. Almeida, M.J.& Laureano, P.(2007). *Memórias do Vinho*, Civilização Editora.
3. Carvalho, J. R. (1948). *Considerações geraes sobre a constituição geológica do Alto-Douro*, Porto.
4. Daveau, S.(1977). *Répartition et rythme des précipitations au Portugal, Memórias do CEG, nº 3*, Lisboa.
5. Decreto- Lei 254/1998, (1998). Retrieved 3 June 2016, available at http: //www.ivdp.pt /pt/docs/ManualCertificaçãoControloDST.
6. Decreto - Lei n.º 8/85, (1985). Retrieved 3 June 2016, available at http: //www.igf.min-financas.pt.
7. Decreto-Lei n.º 166/86, (1986). Retrieved 3 June 2016, available at http: //www.igf.min-financas.pt.
8. Decreto – Lei nº 47/2007, (2007). Retrieved 3 June 2016, available at http: //www.ivdp.pt.
9. Decreto - Lei nº 176/2009 (2009). Retrieved 3 June 2016, available at http: //www.ivdp.pt.
10. Esteves, F. (2008). *Vinhos do Douro.* Edições Civilização.
11. Félix, R. (1984) *Restructuration du vignoble en pente au Douro (Portugal), 64.a Assemblée Generale de l'OIV*, Reunion Commune des trois Comissions, 26-39.
12. Guichard, F., Pereira, G.M., Guimaraens, D., Peixoto, F., De Almeida, A.R., Lopes, T.S., *et al*. (2003). O *Vinho do Porto*. Edições Livro Branco, Lda.
13. Ministério da Agricultura, Comércio e Pescas (2009). Decreto-Lei n.º 173/2009.*Diário da Republica, 148* (1ª Série), 3 de Agosto de 2009.
14. Pedrosa, S., A. Martins, R., & M. Pedrosa, F., T. (2004). *Processo de erosão acelerada. Região Demarcada do Douro. Um património em risco. Estudos e documentos.*
15. Portaria n.º 1080/82 (1982). Retrieved 3 June 2016, available at http: //www.igf.min-financas.pt.
16. Regulamento nº242/2010 (2010). Retrieved 3 June 2016, available at http: //www.ivdp.pt.
17. Regulamento nº. 82/2010(2010). Retrieved 3 June 2016, available at http: //www.ivdp.pt.
18. Regulamento nº. 48/2006(2006). Retrieved 3 June 2016, available at http: //www.ivdp.pt.
19. Rosas, J. R.P (1990). O vinho do Porto - esse vinho humanizado, Observatório, *Revista do sector de acção cultural da Câmara Municipal de Vila Nova de Gaia*, 35-40.
20. Salvador, J. (2007). *As rotas dos Vinhos do Porto, do Douro e de Trás-os-Montes.* Rio de Mouro: Editora Bertrand.
21. Santos, J. Q. M. (1961). *Características geográficas do Alto-Douro e comparação das suas principais demarcações vinícolas, Tese de licenciatura, Faculdade de Letras, Universidade de Coimbra*, Coimbra.

Supported by:

Croatian Academy of Legal Sciences
Croatian Mediation Association
Association of Croatian Judges
Adriatic Institute of the Croatian Academy of Sciences and Arts Ministry of State Property
Ministry of the sea, transport and infrastructure

Sponsored by:

UNIQA osiguranje

City of Solin