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# **Economic and Social Development**

**31<sup>st</sup> International Scientific Conference on Economic and Social Development -  
“Legal Challenges of Modern World”**

**Editors:**

**Marijan Cingula, Douglas Rhein, Mustapha Machrafi**

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## CURT RESOLVE OF THE COMMERCIAL DISPUTES IN THE REPUBLIC OF KOSOVO IN THE PERIOD 2013-2015

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### ABSTRACT

*The aim of this paper is to analyze the legal provisions which adjust the procedure for resolving commercial disputes in the court, the paper, particularly aims to identify the problems that are encountered in practice. The paper is divided into two parts. The first part of the paper deals with the jurisdiction of the court on commercial disputes and the rules that apply to the conduct of commercial contest proceedings whereas, the second part of the paper analyzes the empirical data extracted from the research conducted at the Basic Court in Pristina regarding the trade disputes resolved during 2013-2015. The questions raised in this paper are:- the Rules defining the jurisdiction of the court on economic issues are found within a law or in different laws; -If the rules defining the jurisdiction of the court are found in different laws, is the court competence consistently determined by such rules?; How often business subjects address to the court to resolve their disputes and how effective the courts are in resolving these disputes, and from which relationships the most commonly the trade disputes arise. At the conclusion of the paper, it results that the commercial disputes mostly arise from the violation of the contractual obligations.*

**Keywords:** *business organization, commercial dispute, court, competence*

### 1. THE NOTION OF THE TRADE DISPUTE

The notion of a trade dispute is not defined by the law<sup>1</sup>, in the law, it is only mentioned from which relationships the economic disputes arise. The notion of commercial disputes is provided from the legal theory. In the legal theory, trade disputes are called disputes between business entities related to contracts and other legal transactions that serve the performance of a business activity.<sup>2</sup> Different disputes may arise in the commercial companies, not only between different business entities but also among the founders of the society, among the founders and bodies of the society as well as among the members of society itself.<sup>3</sup> In practice, the most frequent disputes are the consortia of the commercial companies with the third persons regarding the accomplishment or fulfillment of the contracts which the commercial companies bind in order to exercise their business activity.

#### 1.1. The competence of the court in commercial disputes

For the resolution of commercial disputes at the first instance competent is considered the Basic Court<sup>4</sup>, respectively the Department for Economic Affairs, which acts only in the Basic Court

<sup>1</sup> Law No.02/L-123 on business organizations (Official Gazete of the Republic of Kosovo No.39/2008).

<sup>2</sup> F. Brestovci (2004) E Drejta Procedurale Civile II. Prishtinë. Fq.137

<sup>3</sup> A.Jashari (2009) Subjektët e së Drejtës Afariste.Tetovë. Fq.142.

<sup>4</sup> In Kosovo operate 7 Basic Courts: Basic Court of Pristina in Prishtina, which operates on the territory of Municipality of Prishtina, Kosovo Polje, Obilic, Lipljan, Podujevo, Glogovac and Gracanica; Basic Court of Gjilan with headquarter in Gjilan, which operates on the territory municipality of Gjilan, Kamenica, Novo Brdo, Ranilug, Partes, Viti, Klllokot and Vërboc; Basic Court of Prizren, located in Prizren which operates on the territory of Municipality of Prizren, Dragash, Suhareka and Mamusha; Basic Court in Gjakova, located in Gjakova, which operates on the territory of Gjakova, Malisheva, and Orahovac; Basic Court in Peja, operates on the territory of municipality of Peja, Decan, Junik, Istok and Kline; Basic Court in Ferizaj, which operates for the territory of municipality of Ferizaj, Kaçanik, Shtime, Strpce



in Prishtina for the entire territory of the Republic of Kosovo. Thus, the adjudication of economic matters is the sole competence of the Basic Court in Prishtina. According to the previous legislation, namely the Law on Regular Courts of 1978, which was applicable in Kosovo until 2013 until the entry into force of the present Law, the Economic Court was responsible for adjudicating the economic matters. With the new organization of the courts made under the Law on Courts of 2013, the Commercial Court has ceased to exist and the economic issues have been transferred to the jurisdiction of the Basic Court, respectively the economic affair. According to the Law on Courts, the economic disputes that are judged by the deportation on economic matters are considered:

- a) “Disputes between domestic and foreign economic persons in their commercial affairs.
- b) Reorganization, Bankruptcy and liquidation of economic persons, unless otherwise provided by Law.
- c) Disputes regarding obstruction of possession, with the exception of immovable property, between domestic and foreign economic persons in their commercial affairs.
- d) Disputes regarding impingement of competition, misuse of monopoly and dominant market position, and monopolistic agreements.
- e) Protection of property rights and intellectual property.
- f) Disputes involving aviation companies for which the Law on aviation companies applies, excluding traveler disputes”<sup>5</sup>.

Even the special laws regulating bankruptcy, competition, intellectual property, contain provisions which adjust the court jurisdiction over the contested cases, in some cases these provisions differ from the provisions of the Law on Courts by appointing other Courts instead of the Department of Matters Economic Chamber of the Basic Court in Pristina that deal with contested cases in the economic-trade field. For example, the Law on the Court gives the Basic Court in Pristina, respectively the Economic Affairs Department the jurisdiction over the competition law disputes. The competition protection law, however, completely removes the contested disputed cases from the disputes over the Economic Matters. This results from the provision of article 62 paragraph 1 of the Law on Protection of Competition, which states: “Appealing is not permitted against the decision of the Authority, which ascertains violation of this law and pronounces punitive measures as well as the decision which terminates the procedure due to previous issues, however, the party, within a period of thirty (30) days, may initiate an administrative conflict by filing a lawsuit at the Competent Court of Kosovo” and from paragraph.2 of article 62 where it is stated: “Appealing against the conclusion of the Authority ruled out during the procedure is not allowed, however, an administrative conflict may be initiated by filing a lawsuit at the Competent Court of Kosovo.” The Law on Copyright and Related Rights does not expressly define the jurisdiction of the court: “For the proceedings on the infringement of Copyrights and Related Rights decides the competent Court”. No other details are provided in this law that which of the court instances or which of the foundations of the Basic Court has exclusive jurisdiction over copyright disputes. The Law on Trademarks stipulates that the competent court is "a competent court in Prishtina"<sup>6</sup>; this can be understood as the competence of the Basic Court in Prishtina, respectively the competence of the Department of Economic Affairs. Unlike the above-mentioned laws, the Law on Bankruptcy (just like the Law on Courts) expressly states that competent for bankruptcy cases is the Basic Court in Pristina or the Department of Economic Affairs<sup>7</sup>. The Law on Contested Procedure also contains special provisions on territorial competence.

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and Elez Han; Mitrovica Basic Court in Mitrovica, which operates on the territory of Municipality of Mitrovica South and North Mitrovica, Leposavic, Zubin Potok, Zvecan, Skenderaj and Vushtrri. See Article 7 al. 2 of the Law on Courts of Kosovo, No. 03 / L-199.

<sup>5</sup> Law No.03/L-199 on Courts. (Official Gazette of the Republic of Kosovo. No.79/2010). See article 13 par.1.1, 1.2, 1.3 ,1.4 ,1.5 and 1.6.

<sup>6</sup> Law No.04/L-026 on Trademarks. (Official Gazette of the Republic of Kosovo. No.10/2011). See article 2.

<sup>7</sup> Law No. 05/L-083 on Bankruptcy. (Official Gazette of the Republic of Kosovo. No.23/2016). See article 1.14.

Provisions contained in the LCP for territorial jurisdiction in some cases omit the jurisdiction (foreseen by the Law on Courts) of the Basic Court in Prishtina, respectively, for the Economic Affairs Department. For example, for the adjudication of disputes against a legal person of a general territorial jurisdiction under the LCP, the court in whose territory the registered office of the registered legal person is located is considered<sup>8</sup>. While for disputes related to immovable property under LCP, there is a court of jurisdiction in the territory in which the immovable property is located, as per the case in Article 41 par. 1 LCP states: “The court within whose territory is located the immovable property is exclusively competent to adjudicate the disputes that are related to the property and other property rights, disputes over the obstruction to possession of the immovable item, disputes over the lease of the immovable property or contracts for use of residence and working premises”.

## **1.2. Procedural rules for the conduct of commercial disputes procedures**

The procedure in commercial disputes is a special contested procedure regulated by the Law on the Contested Procedure, which applies to resolve the costs arising from the relationships between business entities, respectively commercial companies. Resolving of the commercial disputes requires specialized knowledge on the part of those who resolve them, whereas on the other hand, because of the speed and security of the development of legal turnover in the economy should be resolved as soon as possible.<sup>9</sup> For the resolution of trade disputes, special rules are stipulated other than those applicable to the general litigation procedure. Characteristic of the special contested procedure is the idea for the quickest resolving of the contest between the parties, respectively for the quickest possible grant of the legal protection. Therefore, when it comes to the development of a special contested procedure, including the procedure for resolving commercial disputes, the law provides for shorter deadlines for the full development of the contentious process starting from the response to the lawsuit, the scheduling of the preparatory session, main review, complaint filing, etc. As it is already known, the contested process starts, the court forwards the lawsuit to the respondent who has is entitled to answer the lawsuit after the preliminary examination of the lawsuit. The deadline for filing a lawsuit in trade disputes is 7 days<sup>10</sup>. For urgent cases, it is allowed to the court with a decision to schedule a preparatory hearing or a hearing for the main trial, without forwarding the lawsuit to the respondent for a response, a complaint against this ruling is not allowed. According to the LCP, the preparatory hearing is mandatory with the exception of these two cases a) when the court after reaching the response to the lawsuit finds that there is no controversial evidence between the parties; and b) in the case where the court, due to the incompatibility of the contest, concludes that there is no need to hold a preparatory hearing.<sup>11</sup> Special rules for the preparation of the main review are applicable in the trade contested procedure. For the purpose of accomplishing the idea for faster resolution of commercial disputes by law, the judge is allowed to schedule hearings by phone or telegram for urgent cases.<sup>12</sup> In the commercial contested procedure, the special rules apply for deadlines that are half shorter term compared to the deadlines in the general contested procedure, thus:

- The deadline for responding to the lawsuit is seven (7) days (in the general contested procedure the deadline for response to the lawsuit is 15 days);
- The deadline for submitting the proposal for a return to the previous state is 15 days (in the general contested procedure this deadline is 30 days).
- The deadline for the appeal against the verdict or the decision is 7 days (this deadline in the general contested procedure is 15 days);

<sup>8</sup> Law No.03/L-006 on Contested Procedure (Official Gazete of the Republic of Kosovo. No.38/2008). See article 39.2.

<sup>9</sup> A.Janevski (2009). E Drejta Procedurale Civile, Libri i Parë, E Drejta Kontestimore. Shkup. Fq.442.

<sup>10</sup> Law No.03/L-006 on Contested Procedure (Official Gazete of the Republic of Kosovo. No.38/2008). See article 509.a.

<sup>11</sup> Ibid, see article 401.

<sup>12</sup> Ibid, see article 507.

- The deadline for filing a response to the appeal is 3 days (in the general contested procedure this deadline is 7 days);
- The deadline for meeting the obligation of money is 7 days, while for the meeting of the non-cash promise the court may set a longer term.<sup>13</sup>

The LPK also contains special rules for trade disputes with little value. According to LCP, commercial disputes of small value are considered:

- a) Disputes in which the claim relates to a claim in cash which does not exceed the amount of 3.000Euros.
- b) Disputes in which the claim does not relate to a claim on money, but the plaintiff in his claim declares that he accepts that, instead of the promise not in the money, of money that does not exceed the amount of 3.000 Euros.
- c) The dispute in which the object of the dispute is not the amount of money but the delivery of movable property whose value, mentioned by the plaintiff in the claim, does not exceed the amount of 3.000 Euros.<sup>14</sup>

Another feature in the commercial dispute procedure is that revision in trade disputes is not allowed if the value of the contested object in the affected part of the final judgment does not exceed € 10, 00015.<sup>15</sup>

## 2. EMPIRICAL DATA

In an attempt to provide the most accurate information regarding the issues raised in this paper, a research was conducted in the Basic Court in Prishtina, respectively in the Economic Department. The purpose of this research was to find how often business subjects are addressed to the court for resolving their disputes, respectively how much the court is used as a mechanism for resolving commercial disputes and how effective is the court in resolving disputes and what Legal- Business lawsuits are the most frequent disputes. For the purposes of extracting this data, we have been allowed by the court to have direct access to the registers where the cases are registered, and we have been monitoring the records of the last five years, respectively 2010-2015. It should be noted that the register contains data on: received cases; resolved and unresolved cases; For the object of dispute; the way of settlement; for the use of regular and extraordinary legal remedies and the manner of placement related to them. In addition, we have also conducted interviews with some of the judges of the Department of Economic Affairs.

*Table 1: Percentage of resolved disputes and % of complaints filed against decisions given in trade disputes during the period 2010-2015*

Year	No. of received disputes	No. of resolved disputes within a year	No. of total resolved disputes until October 2016	No. of filed complaints
<b>2010</b>	513	326 (63.5%)	501 (97.6%)	206 (41.1%)
<b>2011</b>	382	243 (63.6%)	379 (99.2%)	171 (45.1%)
<b>2012</b>	622	289 (46.4%)	608 (97.7%)	275 (45.2%)
<b>2013</b>	764	213 (27.8%)	702 (91.8%)	305 (43.4%)
<b>2014</b>	664	173 (26%)	516 (77.7%)	139 (26.9%)
<b>2015</b>	630	66 (10.4%)	227 (36%)	53 (23.3%)

<sup>13</sup> Law No.03/L-006 on Contested Procedure (Official Gazete of the Republic of Kosovo.No.38/2008).See article 509.

<sup>14</sup> Ibid, see article 510.

<sup>15</sup> Ibid, see article 508.

In the chart above are presented the data related to the number of commercial disputes initiated and solved for each year separately as well as the data related to the number of complaints filed against the decisions given in commercial disputes during the period 2010-2015. If we compare the data of 2010, 2011 and 2012 when commercial disputes were adjudicated by the Commercial Court with the data of 2013, 2014 and 2015 when the commercial disputes were adjudicated by the Basic Court in Prishtina, it is noted that the number of disputes has increased since 2013. During the period 2010-2012, 1,517 the disputes were initiated at the Commercial Court, whereas 2,058 the disputes were initiated at the Basic Court in Pristina, respectively in the Department on Economic Affairs during 2013-2015, thus increasing the number of the disputes for 541 (15%). Another significant difference is observed in the percentage of litigation resolved within the year in which they were initiated. The average percentage of the disputes resolved within the year that was initiated at the Commercial Court for the 2010-2012 period is 56.5% and 1,517 initiated disputes are resolved within 858. While in the Department for Economic Affairs the average resolved disputes within the year of which were initiated for the period 2013-2015 is 21.9%, respectively 2,058 initiated disputes have been resolved within 452. Thus, for the same period in the Commercial Court, 406 the disputes were resolved more than in the Economic Department. It should be noted that two judges have acted in the Commercial Court, while 4 Judges operate in the Economic Affairs Department. The small number of disputes resolved within the year, which was initiated by the judge of Economic Affairs, Mr. Bajram Miftari, says no longer relates to the ineffectiveness of their work, but this is due to the large volume of work in their Department. He says that within a year in the Economic Affairs Department there are nearly 900 cases and the largest number of completed cases occupy the cases of previous years inherited from the Commercial Court which should be given priority in relation to the new cases initiated. For example, he points out that he is currently working on cases from 2007 to 2008 and that therefore the duration of reviewing of the trade dispute can take up to a period of 2 years. In addition to the Commercial Disputes in the Economic Department until 2016, the requests for executions or execution of court decisions in commercial disputes have been reviewed, in fact, the largest number of economic cases completed within the year until 2016, execution requirements. For example, in 2015, 630 disputes were initiated within the year, only 66 (10.4%) were resolved within the year, but 290 disputes were initiated several years ago in 2015, but during this year 486 requests for execution of economic disputes.<sup>16</sup> From this it results that during the year 2015 in the Settlement for Economic Affairs 842 cases were conducted; 7.8% of the cases were incurred in disputes initiated by 2015; 30.8% of the cases committed were the disputes initiated prior to 2015; As well as 57.7% of the other cases committed were the requirements for executions. So, the number of cases resolved during 2015 turns out to be roughly a fixed rate of 17-18 cases per judge per month, meaning within a month the proceeding of 68-70 cases on average was completed. From monitoring the public records and analyzing the annual work reports of the court, we have noticed that in general, the Department of Economic Affairs has performed well in terms of reaching the rate of completion of the cases, but due to the high number of cases accumulated from the years previous, the number of outstanding cases remains very high. For example, in 2015 the number of unsolved cases was 4,690 out of them 1,159 were disputes and 3,531 executions (executions). It is worth noting that in 2016 the practice of executing court decisions in commercial disputes changed, i.e. the execution of economic cases has been transferred to the competence of private bailiffs. For this reason, the Basic Court in Pristina and the Economic Affairs Department during 2016 did not receive any request for execution of economic cases, and for a high number of executions (executions) left over from the previous year, a decision which was declared incompetent for their review. Namely, during the first six months of 2016, the court was declared incompetent to review the 1100 requests for execution

<sup>16</sup> See Kosovo Judicial Council (2015) Annual Report of Statistics the Courts, Department of Statistics. Page 9.

or execution of economic cases. This has reduced the number of unsolved cases compared to 2015, respectively during the first six months of 2016, the number of unsolved cases was 3,583 of them 1,152 disputes and 2,431 executions. It should be noted that during the first six months of 2016, 352 commercial disputes were initiated. The total number of cases completed during the first six months of 2016 has been 1,459, respectively, 359 disputes were solved, while for the other 1,100 cases that made up the requests for executions, the court completed the procedure by declaring it incompetent for their review.<sup>17</sup> By comparing this data with the year 2015 where 842 cases were solved (of which 356 disputes and 486 requests for executions), it results that only 617 cases were solved for the first 6 months of 2016 in 2015. If the court performance continues to be the same for the next 6 months of the year, the number of 1,459 solved cases, may be added round 1,400 cases. Thus, the number of cases solved for 2016 is expected to reach about 3,000. Thus, the transfer of the power to review the execution of economic cases to private bailiffs has greatly facilitated the work of the court. It should be argued that in increasing the efficiency of court work during the first six months of 2016, it has also affected that during this period in the Economic Department are engaged (by USAID) three legal officers to assist judges in dealing with economic issues. The judges themselves also emphasized that the engagement of USAID staff has greatly facilitated their work. From this, it turns out that to increase the efficiency of the court it is necessary to engage permanent staff for judges. It is important to note that in the public opinion the question of the quality of court decisions given in commercial disputes is questionable. Even according to various studies carried out in the country, it results that court decisions on trade disputes are generally of poor quality. Thus, in a study conducted by the USAID in 2015, it is stated that "2012 evaluation of judicial decisions by the European Bank for Reconstruction and Development found that the quality and predictability of court judgments in commercial matters in Kosovo are weak." According to the USAID, this is related to the lack of knowledge and experience of judges in specialized areas of the law.<sup>18</sup> Even business community representatives and economic affairs experts in the country say that judges need professional advancement. Kosovo Chamber of Commerce Chairman Safet Gërxhaliu says that judges lack a proper knowledge, particularly regarding terminology.<sup>19</sup> Even according to a study published by the American Chamber of Commerce in Kosovo, respectively by the Arbitration Center in 2016, the lack of specialized knowledge of judges on trade issues turns out to be the main problem in the judicial system.<sup>20</sup> In this study of ACHCK, are included 42 businesses. On the question of how satisfied they were with the functioning/work of the courts when referring to the dispute resolution court, 44% of the businesses (respondents) included in this study stated that they were dissatisfied, 56% stated moderately satisfied, whereas as satisfied enough no one was declared.<sup>21</sup> Our opinion is that the work of the courts, respectively, the quality of court decisions is assessed by comparing the number of appeals filed by the parties to the proceedings against the number of complaints received by the second instance court. For example, during the 2015 dealing on economic issues 356 disputes have been resolved. Of the total of 356 decisions taken against 209 decisions, the parties to the proceedings filed a complaint. Thus, over 58% of the parties to the proceedings during the year have been dissatisfied with judicial decisions. The second instance court during the year 2015 had received more than 209 complaints received from 195 complaints received from previous years. So, during the year 2015, in the second instance court, there was a total of

<sup>17</sup> See Kosovo Judicial Council (2016) Statistical Report of six-month period 2016 on the work of the courts, Department of Statistics .Page 9.

<sup>18</sup> <http://zeri.info/ekonomia/38214/kontestet-gjyqesore-pengese-per-investitoret/> artikulli i publikuar më datën 22 qershor 2015| ora 09:01 (visited with the date.17.11.2016).

<sup>19</sup> <http://gazetatribuna.com/lajme/ceshtjet-ekonomike-sfide-per-gjyqtare-dhe-prokurore/> artikulli i publikuar më 28 Shkurt 2016| 15:38 (visited with the date 17.11.2016).

<sup>20</sup> Studim Vjetor i Qendrës së Arbitrazhit (2016) Qendra e Arbitrazhit në Oden Ekonomike Amerikane në Kosovë.Fq.14 (Available at: [http://www.adr-ks.org/site/shenimet/files/5964/studim\\_qendra\\_e\\_arbitrazhit\\_2016.pdf](http://www.adr-ks.org/site/shenimet/files/5964/studim_qendra_e_arbitrazhit_2016.pdf)).

<sup>21</sup> Ibid, see Page.7.

404 cases at work. Of the 404 cases that were in operation by the end of the year the year 2015 were solved 298 cases (or 73.7%), thus: for 172 cases (or 57.7%), the first instance decision was verified; For 26 (or 8.7%) the complaint cases had been dismissed (as delayed, incomplete or inadmissible); whereas for the other 100 cases (or 33.5%) the complaint is accepted as grounded, whereas, during the first six months of 2016, the second instance court received 175 new cases at work and 106 cases remained in work from the previous year.<sup>22</sup> Thus, throughout the first six months of 2016, at the second instance court, 281 cases were in operation, of which 86 were solved (or 30.6%), thus: in 3 cases (or 3.4%) the complaint was dismissed; for 35 cases (or 40.6%), the first instance verdict was verified, whereas, for the other 48 cases (or 55.8%), the complaint was accepted as grounded.<sup>23</sup> Thus, compared to 2015, during the first six months of 2016, it is noted that the percentage of complaints received as late for 22% has increased. It should be noted that as a second instance court there is an Appellate Court where 37 judges are employed, with only 2 judges being taken on economic matters. Although in most cases the parties are dissatisfied with the court decisions, as evidenced by the high number of complaints filed, businesses still resolve their disputes mostly by the court. All this results from the high number of disputes initiated within a year in court, for example, in 2015 the court addressed 630 businesses to resolve their disputes. In the study conducted by ACHCK in 2013 (referred to above) regarding the contest resolving, 61% of the businesses involved in the study stated that they resolved their disputes to the court, whereas only 19 % have expressed that they have resolved arbitration for resolving their disputes.<sup>24</sup> Thus, the court remains the most used mechanism or method used by businesses to resolve their disputes. The main reason for the selection of the court besides the arbitration according to the study carried out by the ACHCK results to be the lack of the appeal procedure against the decision given in the arbitration proceedings, for which parties the court decision considers the most pompous in relation to the arbitral award. As other reasons mentioned the lack of proper information of businesses for the functioning of arbitration and the fact that arbitration is more expensive than court proceedings.<sup>25</sup> We also consider that the main reason for choosing the court in addition to arbitration in our country is the higher cost of the arbitration procedure as well as the lack of awareness of the business on the functioning and importance of dispute resolution through arbitration. Also, the election of the court is also linked to the greater legal certainty the parties feel to the court in relation to arbitration, as traditionally the court is considered a safer system.

*Table 2: Percentage of resolved disputes (lawsuits) for the period 2013-2015 in the Basic Court in Pristin*

Year	Compensation of the Damage	Return of the Debt	Protection of the Trade Mark	Protection of the Copyright	Protection of the License	Ungrounded Enrichment	Property Obstruction	Verification of the Property	Others
2013	31.6%	49.4%	1.8%	0.02%	0	0.2%	0.7%	0.4%	10.3%
2014	41.4%	36.4%	3.4%	0	0.38%	2.3%	0.58%	0	10.4%
2015	44.9	29.5%	4.4%	1.3%	0	7.4%	0	0	6.6%

<sup>22</sup> See Kosovo Judicial Council (2015) Annual Report of Statistics the Courts, Department of Statistics. Page 8.

<sup>23</sup> See Kosovo Judicial Council (2016) Statistical Report of six-month period 2016 on the work of the courts, Department of Statistics. Page 8.

<sup>24</sup> Studim Vjetor i Qendrës së Arbitrazhit (2016) Qendra e Arbitrazhit në Oden Ekonomike Amerikane në Kosovë. Fq.7 (Available at: [http://www.adr-ks.org/site/shenimet/files/5964/studim\\_qendra\\_e\\_arbitrazhit\\_2016.pdf](http://www.adr-ks.org/site/shenimet/files/5964/studim_qendra_e_arbitrazhit_2016.pdf)).

<sup>25</sup> Ibid, see Page 15.

The table above shows the data regarding the nature of lawsuits resolved for the period 2013-2015 in the Basic Court in Prishtina, respectively in the Economic Department. From the monitoring of the public registers of economic cases (disputes) of 2013-2015, we have noticed that the largest number of lawsuits comprises claims for compensation of damage and debt repayment due to non-fulfillment of different contractual obligations or irregular fulfillment of Contractual obligations. As can be seen from the data presented in the table above, claims for compensation and debt repayment in 2013 accounted for 80% of the lawsuits in 2014, over 77% and 73% in 2015. Therefore, the largest number of disputes arises from a breach of contractual obligations. The Judges of the Economic Department of the Basic Court in Pristina point out that one of the most common problems regarding claims for compensation due to non-compliance with the contractual obligations is that these requirements are quite often based on informal or oral contracts. This means that businesses do not pay attention to written agreements, which creates difficulties in establishing the existence of a contract or conditions under which contracts have been concluded in cases where between the parties various disputes arise regarding the performance of the contract. It is important to note that Kosovo and world rankings are ranked poorly as a result of non-execution of contracts. This is the result of World Bank reports called "Doing Business", according to which as a result of non-performance of contracts, Kosovo ranks weakest in all the countries of the region and weaker than all other EU countries with the exception of Italy. Accordingly, according to the World Bank's "Doing Business for 2010" report on non-execution of contracts, Kosovo is ranked 157th in the list of 183 countries in the world; For 2011 is ranked 155 in the list of 183 countries in the world; For the year 2012 is ranked 157th in the list of 183 countries in the world. While, for the year 2013, ranked 138 in the list of 185 countries in the world as well as for 2014 and for 2015 is also ranked 138 in the list of 189 countries in the world. (See Appendix no.1). Thus, according to the World Bank, during the period 2010-2015, Kosovo didn't make any progress in improving ranking in terms of execution of contracts. We consider that the high number of business disputes resulting from the violation of contractual obligations and, on the other hand, the length of the court's review of these disputes negatively affect the attraction of foreign investment in the country.

### 3. CONCLUSION

The provisions of the Law on Courts is clearly defined that the competent court for adjudicating of economic affairs is the Basic Court in Pristina, respectively the Department of Economic Affairs and are clearly defined the relations from which the trade disputes arise. From what was considered in this paper it turns out that the main difficulties faced by the competent court for the adjudication of commercial disputes are the high number of pending cases due to the small number of judges and the lack of professional associates as well as lack of knowledge of Specialized judges for certain types of commercial disputes, for which parties in most cases are dissatisfied with the work of the court, namely from the data analyzed in this paper it was proved that:

- The number of commercial disputes initiated for the court settlement within one year is high, and the number of disputes resolved that are initiated within the year is very low. For example, for the period 2013-2015 in the Basic Court in Prishtina, 2,058 disputes were initiated within them, 452 or 21.9% were resolved within the year. The small number of disputes resolved within the year they have been initiated cannot be said to be the result of the poor performance and ineffectiveness of the court, as the court generally does well in terms of reaching the rate of completion of the cases. But it is a result of the high number of work-related cases from previous years which should ordinarily be given priority over new cases initiated.



Apart from commercial disputes, the Basic Court in Pristina by the year 2016 has also been taken to execute or execute economic cases, which have been numerous in number.

- The number of unsolved cases at the end of 2015 in the Basic Court in Prishtina marked 4,690 of them 1,159 disputes and 3,531 executions.
- The number of complaints filed against the decisions given in commercial disputes is high. For example, in 2015 the Basic Court in Prishtina completed the procedure for the trial of 356 commercial disputes. Of the total of 356 decisions taken against 209 decisions, the parties to the proceedings filed a complaint. Thus, over 58% of the parties to the proceedings during the year had been dissatisfied with judicial decisions.
- The largest number of trade disputes arises from the breach of contractual obligations. For example, out of 1,445 disputes that were solved during the period 2013-2015 at the Basic Court in Pristina, claims for 1,140 disputes consisted of claims for compensation for damage and debt repayment due to non-fulfillment of various contractual obligations or improper performance of Contractual obligations. Thus, over the period 2013-2015 in the Basic Court in Prishtina over 78% of the lawsuits in commercial disputes included claims for compensation of damage and debt repayment.

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# APPENDIX

	<b>RBB 2010</b> <i>(The ranking in the world from 183 countries)</i>	<b>RBB 2011</b> <i>(The ranking in the world from 183 countries)</i>	<b>RBB 2012</b> <i>(The ranking in the world from 183 countries)</i>	<b>RBB 2013</b> <i>(The ranking in the world from 185 countries)</i>	<b>RBB 2014</b> <i>(The ranking in the world from 189 countries)</i>	<b>RBB 2015</b> <i>(The ranking in the world from 189 countries)</i>
<b>Kosovo</b>	<b>157</b>	<b>155</b>	<b>157</b>	<b>138</b>	<b>138</b>	<b>138</b>
<b>Albania</b>	91	89	85	85	124	102
<b>Macedonia</b>	64	65	60	59	95	87
<b>Bosnia Herzegovina</b>	<b>124</b>	<b>124</b>	<b>125</b>	<b>120</b>	<b>115</b>	<b>95</b>
<b>Serbia</b>	97	94	104	103	116	96
<b>Montenegro</b>	<b>133</b>	<b>135</b>	<b>133</b>	<b>135</b>	<b>136</b>	<b>136</b>
<b>Croatia</b>	45	47	48	52	49	54
<b>Slovenia</b>	60	60	58	56	52	122
<b>Slovakia</b>	61	71	71	69	65	55
<b>Bulgaria</b>	87	87	87	86	79	75
<b>Romania</b>	55	54	56	60	51	51
<b>Hungary</b>	14	22	19	16	14	15
<b>Greece</b>	89	88	90	87	98	98
<b>Italy</b>	<b>156</b>	<b>157</b>	<b>158</b>	<b>160</b>	<b>103</b>	<b>147</b>
<b>France</b>	6	7	6	8	7	10
<b>England</b>	23	23	21	21	56	36
<b>Austria</b>	11	9	9	7	6	5
<b>Germany</b>	7	6	8	5	5	23
<b>Belgium</b>	21	21	20	18	16	10
<b>Sweden</b>	51	52	54	27	25	21
<b>Denmark</b>	28	30	32	34	32	34
<b>Finland</b>	8	11	11	9	8	17
<b>Ireland</b>	2	1	3	3	3	18
<b>Spain</b>	52	52	54	64	59	69
<b>Portugal</b>	22	25	22	22	24	27
<b>Poland</b>	75	77	68	56	55	52
<b>Estonia</b>	49	50	29	31	26	32
<b>Lithuania</b>	17	17	15	14	17	14
<b>Latvia</b>	15	14	17	24	21	16
<b>Czech Republic</b>	82	78	78	79	75	37
<b>Cyprus</b>	<b>107</b>	<b>104</b>	<b>105</b>	<b>108</b>	<b>110</b>	<b>113</b>
<b>Luxemburg</b>	1	1	1	1	1	2
<b>Netherlands</b>	30	29	28	32	29	19

*Burimi: World Bank (Report “Doing Business” 2010-2015)*

## POSSIBILITIES AND CHALLENGES OF APPLICATION OF FLEXICURITY MODEL IN CROATIAN LABOR LAW

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### ABSTRACT

*Flexicurity comes from the words flexibility and security. The term flexicurity dates back to the 90s of the twentieth century and means employment security, not job security, in fact, it should be a worker protection institute, not a workplace protection institute. This paper will explore the possibilities and challenges of applying flexicurity within labor relations and the labor market of the Republic of Croatia. After the war, the unemployment in the Republic of Croatia was high. What is important to do in such a situation is to strengthen the economy in the country, employ workers, taking into account social standards to preserve the dignity of workers, because the crisis in the new EU member states has led to precarious labor, whose characteristics are insecurity, fixed-term employment, almost nonexistent workers' rights, preferring illegal work, seasonal work etc. Each EU member state needs to build its own path leading to employment security and to social standards appropriate to that particular country. Most experts in this field believe that current labor law institutes will have to change or adapt to labor market conditions, but that's not a quick and easy task. The Croatian labor market must also change in terms of employment protection, payroll, social unemployment measures, labor disputes. According to Professors Bodiřoga and Laleta there are possibilities for this and these are:*

- *higher labor market flexibility that affects the reduction of unemployment and*
- *one-off structural reforms*

*In this way flexicurity would reach its full potential in practice. The professors give preference to the German "new model" that brings out the best from the current state so that it is apparent that the application of this model results in high employment.*

**Keywords:** *Croatian labor market, flexicurity, German "new model", precarious work*

### 1. INTRODUCTION

The term "flexicurity" dates back to the 90s of the twentieth century and means employment security, not job security, in fact, it should be a worker protection institute, not a workplace protection institute. The word "flexicurity" is the derivative of two words, that is flexibility and security, and its aim is to create safety for workers. Ronald Sultana from the University of Malta pointed out that the term flexicurity "reflected the growing trend of employers who preferred more relaxed approach to the legitimate protection of their employees. The same trend would provide sufficient flexibility in fast employment and dismissal of employees, and in internal adjustment of job organization in their companies (eg shortening of working hours, which means a reduction in employee costs), depending on the different business cycle requirements. However, increased employer flexibility can result in increased employee insecurity. The policy of flexicurity seeks to reduce and manage this uncertainty through:<sup>1</sup>

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<sup>1</sup> Sultana, Ronald G., Flexicurity: Implications for Lifelong Professional Orientation, European Lifelong Learning Network (ELGPN), 2011/12 Coordinator. Jyväskylä University, Finland, Finnish Institute for Research in Education (FIER), 2013

- measures outside the company<sup>2</sup>
- measures within the company<sup>3</sup>

The European Commission, employers, trade unions, civil society organizations, political leaders and so on have been very much involved with this institute. However, the EU has a political program on flexicurity. The Joint Advisory Committee of Croatia-EU sought to present flexicurity in the debate on flexicurity through the views of various stakeholders in the EU. The aim is to find a solution for reforms that lead to the equalization of opinions, ie the legal regulations of individual states through EU Laws on Labor and Social security. Various models of flexicurity are coming in the labor market. Danish model is highly praised, but as well as other models it should be observed within certain constraints both spatial, temporal and political. Danish Prime Minister Poul Nyrup Rasmussen first used the word flexicurity. "With this measure, Denmark has reduced unemployment by 50% in just five years. Today, unemployment in Denmark is only 5.6%.<sup>4</sup> "Flexicurity has become one of the most sought-after measures across Europe, particularly in Germany and France, which are facing unemployment and economic recession. The Danish employment ministry defines flexicurity as a "golden triangle," which consists of three essential components:

- Flexibility on labor market-Work contracts allow employers to easily release or recruit
- Social security for employees - Being unemployed is not a big problem for Danish citizens. The person losing a job will receive a good unemployment benefit and other forms of help
- Active employment policy -includes re-qualification programs according to the needs of the market but also severe sanctions for those who abuse their status as unemployed persons. In order to receive unemployment benefits, people must actively engage in seeking new jobs and / or retraining programs.”<sup>5</sup>

The goal is the same for all, and this is more of a better job, which targets greater security of employment and protection of workers in terms of their social standards and their dignity. Professors Laleta and Bodiřoga-Vukobrat give an advantage to the German "new model", which results in high employment on the labor market. In their work "Flexicurity and Labor Market deregulation" they emphasize that the main issues and controversies involved in their research paper are inextricably linked to flexicurity and the labor market are new governance model, soft law, open method of coordination, European social model, inclusion and labor market.<sup>6</sup> The EU is financially assisting the European Network of Lifelong Learning Professional (ELGPN), a network of member states that develops a lifelong learning program and is also fully advocating the views of the network. The Jyväskylä University of Finland was a network coordinator for 2011-12. year. As far as the Republic of Croatia is concerned, we will consider here the possibility of applying flexicurity. We advocate the principle of easy employment of workers, as well as easy layoff of workers.

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<sup>2</sup> Measures outside the company (external flexicurity) eg through the protection of the unemployment benefits and the high level of investment in active labor market policies such as additional training between employment periods and information, counseling and professional guidance services to assist in matching supply and demand on the labor market )

<sup>3</sup> Measures within the company (internal flexicurity) eg through the assurance that the worker for job distribution and the acceptance of tasks within companies that are not part of the employment contract will in return get a minimum salary that meets an acceptable standard of living.

<sup>4</sup> [https://www.posao.hr/articles\\_all.php?ID=102&page=1](https://www.posao.hr/articles_all.php?ID=102&page=1), Flexicurity of European Employment? p.1. 04/02/2018.

<sup>5</sup> Ibid.

<sup>6</sup> Laleta, S, Bodiřoga-Vukobrat N., Fleksigurnost i (de)regulacija tržišta rada (Flexicurity and (de)regulation of the labor market ), The Proceedings of the Faculty of Law, University of Rijeka (1991) v.37, No.1, 33-69, Rijeka, 2016.

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In the section on flexicurity application in the Croatian labor market, the implementation and operation of this institute will be presented on the premises of our labor market. According to Eurostat data available for 2017, Croatia's unemployment rate for 2010 was 11.8%, while in 2016 it was 13.3%. We know that Croatian citizens had had difficulties finding a job for many years. Young active citizens have the knowledge, willingness, responsibility, but have no chance of employment due to labor market rigidity, economic problems, corruption, gray economy. Not to mention that from low unemployment benefits they can't survive, also pointing out the need for fast retraining and investing in oneself. The education system does not provide them with quality and fast re-qualification programs, while demanding the programs to be paid for. In terms of recession, globalization and market economy, more flexible forms of work become inevitable. Greater fluctuation of workforce increased even more since joining the EU. In the open European labor market, there is greater competition of skilled workers. The question is how to balance labor market based on the aspiration to accumulate as much capital as possible and on the other hand the aspiration for the creation of a welfare state based on the principles of social justice. "The rough economic logic often undermines the reaches of the European social model and the solutions of the institutes that have guaranteed dignity at work and high social standards. One of the biggest problems of the Croatian society and economy is the long-term and high level of unemployment, so the search for ways of solving this issue that will enable the competitiveness of the Croatian economy on both the European and world markets becomes one of the priorities."<sup>7</sup> "The complexity of the research we conducted on flexicurity has shown that we can not only address the challenges of labor law institutes, but also the results of economic research. It should direct the legal science to proposing possible solutions to *de lege ferenda* that will not cause social confusion and tensions, while at the same time being economically efficient and enforceable."<sup>8</sup> "Different economic systems, economic policies and the legal culture of member states required each and every country to find their own ways and possible solutions that would respond to a new situation that both Europe as a whole and as well as the Member States were not prepared for after years of economic prosperity."<sup>9</sup>

## 2. FLEXICURITY -INSTITUTE OF THE FUTURE

The Institute of Flexicurity creates a platform for uninterrupted dialogue between trade unions and employers in the Nordic countries, while in the Eastern European and Mediterranean countries of Europe it is more difficult to apply because of the constant antagonism between work and capital. The economy of the EU countries is unproductive, non-transparent and uninteresting for large investments. It is necessary to change rigid bureaucracy as soon as possible, also to change the system of education and connect theory with practice, to encourage productive occupations, to provide incentives for education, to introduce lifelong learning through higher education institutions and vocational schools, to enable education for those at the bottom of the financial scale but with capacity, dealing with human potentials, recognizing quality, introducing flexibility of labor legislation, and so on. Poul Nirup Rasmussen said that "Europe can expect its economic growth only through social dialogue in society, but also economic policy that will promote competitiveness, lifelong learning, active employment policy and high, tax-financed unemployment benefits. According to him, Denmark's success can be achieved in other countries of Europe as well. In the era of ubiquitous recession and almost 20 million unemployed, let's hope that it will."<sup>10</sup>

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<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> Op.cit. (note 4) p. 3

## 2.1. Croatian model of flexicurity

Most experts in the field believe that current labor-market institutes in the Republic of Croatia will have to change or adapt to labor market conditions, but this is not a quick and easy job. The Croatian labor market has to change in the direction of employment protection, payroll, social unemployment measures, then solving labor disputes. First, the sunken Croatian economy needs to be strengthened, fiscal policy needs to be brought into realistic frameworks that is stifling the economy rather than stimulating the economic and social projects that are important for economic development and the stability of national economy. Reducing bureaucratization in public administration and establishing the labor market on realistic foundations, therefore greater flexibility in the labor market is needed. One-off structural reforms need to be implemented, reducing unemployment, which still has a growth trend. Every national economy must find its way of prosperity. "The unemployment benefit policy in the Republic of Croatia should take into account the current cultural circumstances that are difficult to change for a short period of time. Depending on the amount of the previous salary, the remuneration in the Republic of Croatia should be determined according to a strict control system, ie monitoring if the unemployed person is sufficiently active on the labor market. If this is the case, there is no reason for the unemployment fee not to be sufficiently high. On the other hand, those who do not have active intentions to find a job by (strict) definition should not be in statistics of unemployment. Then we come to an even greater problem of the Croatian labor market, which is inactive workforce (because it is not looking for a job at all while still in the working age.). This part of the population is larger than the unemployed because a part of them gained early retirements. High fees are not possible in Croatia (for now) "<sup>11</sup> The problem of the Republic of Croatia is a very unfavorable demographic picture of the population, which has been discussed a lot lately. When we put that picture in the context of the labor market we see a very unfavorable situation, which is a very low rate of active workforce in the general population. For decades, we have a low natural population growth, our birth rate has fallen, mortality has increased, emigration is very high. Along with all this, a very high unemployment rate in both crisis years (2013 and 2014) was 17.3%, and in 2016 it was 13.3. %, was especially a problem for the young population where the percentage reached 49.9% in 2013, and dropped in 2016. to 31.5%. As in other European countries, long-term unemployment is a burning problem in the Republic of Croatia.

*Table 1: Percentage of active workforce (15-64 yrs) and their unemployment rate (2010-2016).*

	ACTIVE WORKFORCE		UNEMPLOYMENT RATE	
	2010.	2016.	2010.	2016.
EU-28	71	73	9,6	8,5
Denmark	79,4	80	7,5	6,2
Germany	76,7	78	7	4,1
Republic of Ireland	69,4	70,5	13,9	7,9
Greece	67,8	68,2	12,7	23,6
Croatia	65,1	65,6	11,8	13,3
Italy	62	64,9	8,4	11,7
Slovenia	71,5	71,6	7,3	8
United Kingdom	75,4	77,3	7,8	4,8

*Source: EUROSTAT (gathered on July 15<sup>th</sup> 2017.*

<sup>11</sup> The Danish model of flexicurity is a happy compromise, the Center for Public Policies and Economic Analysis CEA, NGOs, Zagreb, Croatia, 2009.

"Croatia also has a high rate of precarious labor which, despite the increase in employment and economic recovery, is growing. From the above mentioned problems, and in the context of flexicurity, we can conclude that there is strong segmentation on the Croatian labor market ."<sup>12</sup>

## **2.2. The Danish model of flexicurity**

Let's remember that Denmark in the 1970s was a country that wrongly assessed, chose, and applied social policy. There was great unemployment after oil shocks. Denmark has allocated a large amount of money to unemployed people. These large benefits to the unemployed resulted in the fact that active workforce in the population didn't want to work because they were living well from social benefits. They did not look for a job and did not stand for further education and retraining. And then, in the early 90s of the last century, had flourished a program of flexicurity that reflected in a very easy layoff of workers, but also in a very simple job finding. And now the unemployment benefits amounted to 90% of the last received salary). Workers are in no way stressed about losing their jobs. BBC News in the foreword states that Heidi Lyngsa's employee was fired because the Carlsberg brewery was shut down. For four years, the worker received unemployment benefit in the amount of 90% of the last salary and in that period completed the re-qualification program for the care of old and helpless persons. However, the employee mentioned that she has some obligations towards the state as eg the an obligational acceptance of a job offer. It can only deny a job offer once. In addition, if you do not want to lose the unemployment allowance you must accept any job that is 2 hours away from your residence. All rights and obligations are regulated through the local Employment Bureau, which must be notified within 24 hours of the loss of employment. Denmark has high tax rates (up to 60% of income), but this money is channeled into social projects. Annually, 250 000 work contracts are canceled, and so many new ones are signed. Therefore, in Denmark the fixed-term employment contract is no exception but the usual way of working relationships.

## **2.3. The Dutch model of flexicurity**

"On the concept of flexicurity, the Dutch sociologist Hans Adriaansens spoke in his speeches and interviews for the first time in the mid 1990's in the Netherlands, in the context of preparing the Dutch Flexibility and Security Act on Employee Distribution through a Mediator (Wilthagen and Tros 2004, van Oorschot 2004). The mentioned two laws were supposed to provide additional labor market flexibility by providing easier layoffs and more flexibility for temporary employment agencies on the one hand, while at the same time creating greater security for flexible workplaces on the other hand (Wilthagen et al. "<sup>13</sup> "The main goal was to reconcile the interests of employers and workers, while strengthening and competitiveness and protection. As a result, a Dutch model of flexicurity was born. The Dutch model of flexicurity is committed to the application of atypical, flexible types of employment, while at the same time allowing these flexible types of employment similar rights in terms of working and social security, similar to those of a standard working relationship. "<sup>14</sup> This flexicurity model began to be studied very quickly in the academic community of some countries.

## **2.4. German model of flexicurity**

Until now, there have been restrictive unemployment suppression measures in Germany that are reflected in the small unemployment benefits they receive for a shorter time than in the Nordic countries, leading to the rigidity of the system to quickly find new jobs.

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<sup>12</sup> Jakšić Ostrovidov, A., Postoji li mogućnost primjene koncepta fleksigurnosti na tržište rada u Republici Hrvatskoj (Is there a possibility of applying the concept of flexicurity to the labor market in the Republic of Croatia), *Economic Trends and Economic Policy*, 26, No. 1 (140), Zagreb, 2017.

<sup>13</sup> Parnis, M. G., *Fleksigurnost u Europskoj uniji (Flexicurity in the European Union)*, 5th meeting, Prague, May 5, 2009.

<sup>14</sup> Ibid.

The "German" model of recruitment has recently attracted attention ... With the decline in unemployment rates and a record high level of newly created jobs Germany is now considered a benchmark country with a continuous growth of employment. It is also important to emphasize that new employment is not only based on the opening of "bad jobs" on the margins of the labor market by its deregulation, but also by a large number of "good jobs" linked in particular with qualified occupations in the service sector "<sup>15</sup> German legal literature is said to be very extensive, which should result in rapid and extensive changes in the labor market, but this is not the case because the deregulation measures were adapted to the existing labor law. Why is it like that explains Blanke in his research paper *Autonomisation of Labor Law through Judicial Interpretation*<sup>16</sup>

### 3. LABOR LAW AND SOCIAL STANDARDS

Lord Wedderburn speaking about the legal regulation that follows this problem pointed out that the labor law was not exposed neither as a basis for this state of affairs nor as a framework that protected the phenomenon at the time of its emergence. Today, however, Europe places the emphasis on social standards.<sup>17</sup> Now flexicurity is legally covered by many documents, such as Agenda 2020 EU, as the core document from which the Agenda for New Qualifications and Jobs, the European Employment Strategy and others.<sup>18</sup> Blanke in his research paper *Autonomisation of Labor Law through Judicial Interpretation* points out that the maintenance of labor law reform is largely shaped under the influence of judicial practice, collective agreements and legal theory.<sup>19</sup>

### 4. MODERN SOCIAL SECURITY SYSTEM

The goal was to create a modern social security system which implies that the unemployed have a solid unemployment fee to bypass their time of unemployment and to be active in seeking employment and returning to the labor market. However, many consider this to be a passive employment policy (cash compensation and early retirement), so many reforms have been carried out in the past fifteen years in order to encourage unemployed people to seek employment, reduce fees, introduce part-time work, reduce work in gray economies due to their involvement in retraining or acquiring new knowledge in the labor market. Collective contracts protect workers more than legal regulations. Their disadvantage is that they only protect the workers of a particular group. In most countries the provisions of collective agreements refer to all workers, whether they are union members or not. Recently, the interest in union membership has declined greatly. From our reality we see that unions are under the influence of employers and workers can hardly exercise their rights through them and be protected even though it should be contrary to workers to feel safely. Older people show more interest in joining the Unions than the young and it needs to be point out that more people join Unions in the public than in the private sector. Companies and workers in Europe need to adjust quickly in creating new jobs, not to preserve the existing ones because it is imposed by the labor market. Workers must not be in a disadvantage when they are confronted with changes in their workplace, they must be timely informed and educated about change, undergo various counseling to mitigate the changes that have occurred. Social dialogue is crucial in the flexicurity model. Strong social partners are needed for realization.

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<sup>15</sup> Op.cit. (note 6) p. 50

<sup>16</sup> Blanke, T., *Autonomisation of Labour Law through Judicial Interpretation*, in: *Reflexive Labour Law-Studies in Industrial Relations and Employment Regulation* (ed. R. Rogovski, T. Wiltshagen), Deventer, Kluwer, 1994, p. 207-224., op. cit. according to Rogovski, R., op.cit., p. 155-156, op.cit. (note 6) p. 3

<sup>17</sup> Lord Wedderburn, K. W., *Labor Law 2008, 40 Years On*, *Industrial Law Journal*, vol. 36, br. 4, 2007.

<sup>18</sup> EC, *Agenda 2020, A strategy for smart, sustainable and inclusive growth*, COM (2010)2020 final, Brussels, 3.3.2010, EC, *An Agenda for new skills and jobs: A European contribution towards full employment*, Strasbourg, 23.11.2010, COM (2010)682 final, European Council, *Euro Plus Pact*, 2011.

<sup>19</sup> Op.cit. (note 16) p. 155-156



Employers should invest maximum in their workers, in their status in education, in the culture of living, in preserving the stability of the family, and states should stimulate employers to do so. Likewise, each individual worker should take responsibility for personal life and work through available social policy measures. Some groups of workers are more vulnerable than others. Eg. young unqualified workers, women, migrants are more vulnerable to different forms of life insecurity. For this reason, funds should in principle be more directed towards those categories in order to prevent the precariousness and vulnerability of these categories of workers. Inevitably, professional guidance counselors are needed in the context of flexicurity. This creates new challenges regarding professional guidance (eg when a parent withdraws from full-time employment to care for and educate children, but in that sense they do not think that they will face the difficulty of returning to work later on time (outdated skills of losing self-confidence, loss of contact with their generation).

## 5. CONCLUSION

In EU countries, employers struggle for flexible workforce, young workers ready for rapid change and constant adaptation. Workers, on the other hand, need financial security and the ability to quickly find a new job. Flexicurity model gives a sufficient degree of flexibility for competitiveness, but also security for those participants affected by changes in the labor market. It is necessary:

- Improve labor legislation under labor market conditions
- encourage the active labor market policy
- encourage the system of lifelong learning
- introduce a modern social policy
- identify groups of workers who are in danger of being excluded from the labor market and working with them (preparation for employment through education and acquisition of market-relevant skills learning abilities, opportunities recognition, skills management- to balance the income security and self-sufficiency).

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## NEXUS BETWEEN HUMAN CAPITAL DEVELOPMENT AND HUMAN CAPITAL INVESTMENT IN NIGERIA

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### **ABSTRACT**

*Human capital development has been identified as one of the major keys of economic development. This study examines the nexus between human capital investment and human capital development in Nigeria using time series data spanning through 1983 to 2015. The study made use of Phillip Peron to test for stationarity and Vector autoregressive model (VAR) was employed in the study to analyze the complex relationship of human capital investment and human capital development. The study revealed causality relationship between human capital investment and human capital development in Nigeria. The findings also show that both Total Factor Productivity, Education expenditure, Health expenditure and Life expectancy exhibited impact on human capital development in Nigeria. The study recommended that concerted effort should be made to improve on both Education and Health spending in order to increase human capital development in Nigeria. In addition government should make appropriate policy that will increase life expectancy. This will guarantee improvement in Nigeria human capital development.*

**Keywords:** *Human Capital Development, Human Capital Investment and Total Factor Productivity*

### **1. INTRODUCTION**

The major economic challenge of underdeveloped countries is economic development. Global community is also faced with the problem of how to achieve sustainable development. Oluwatobi and Ogunrinola, (2011) opined that economic development, social development and environmental protection are pillars to maintain and enhance the capacity and capability of future generation. This can only be achieved if human capital is strategically cultivated and positioned. Human capital has been recognized globally as one major factor that is responsible for the wealth of nation (i.e. economic development). Human capital refers to the acquired and useful abilities of all inhabitants or members of a given society {Omojimate, Ben, (2010)}. The report of the World Bank in 2010 specifically made it clear that Nigeria has found it difficult to make her economy grow in her effort to become a knowledge-based economy because of the challenges faced in the National Education System. The challenges include teaching with obsolete methods, strikes and administrative incurs corruption in the education sector, lack of infrastructure and other teaching methods and poor funding. World Bank categorized these problems into poor access to education, poor quality of education and poor funding of education. The issue of funding has been a critical issue militating against human capital development. Oluwatobi & Ogunrinola (2011) are of the view that all the challenge confronting knowledge and skill (Human Capital) development in Nigeria is lack of fund and where fund is available, it is not efficiently allocated. The World Bank (2010) also agreed that government funding for university research is too low. Since, it has been identified that there can be no significant economic growth in any country without adequate human capital. Hence, there is need to study the relationship between human capital development and human capital investment. The broad objective of this study is to investigate the nexus between human capital investment and human capital development in Nigeria.

However, the specific objectives include:

1. to examine shock transmission among the variables.
2. to investigate the existence of causal relationship among variables of interest.

## **2. LITERATURE AND EMPIRICAL REVIEW**

The role of human capital formation has long been recognized in the literature. According to Habison (1973), human beings are the active agents who accumulate capital, exploit natural resources, build social, economic and political organizations and carry forward natural development. This clearly shows that human capital is key to economic development because it serves as coordinating factor. Therefore, any country which fails to develop the skill and knowledge of its citizen and effective utilization of its human resources will find it difficult if not impossible to develop. According to Todaro (1990), human capital often used to mean education, health and other human capacities that can raise productivity. Schultz (1962) opines that Education is a kind of investment in human being that enables them to acquire skills. Such skills raise the marginal product of the worker itself and also help to raise the marginal product of the other. Human capital development through education is associated with knowledge acquisition. Ramirez, Ranis and Stewart (1997) employing cross country data investigated the channels through which human capital development affects economic growth and vice versa. The study argues that economic growth may lead to human capital development and human capital development could also lead to economic growth. This bi-directional relationship could lead to virtuous or vicious cycles of economic growth. The study finds that countries which promoted economic growth tend to achieve the virtuous category while countries which favoured human capital development encounter the virtuous growth. Ogujiuba and Adeniyi (2004) examined the impact of government education expenditure on economic growth. Their result showed a statistically significant positive relationship between economic growth and recurrent expenditure on education, while capital expenditure was wrongly signed and not significant in its contributions. Omotor (2004) analysed the determinants of federal government expenditures in the education sector in Nigeria using the ordinary least squares (OLS) methods. The study revealed that the trend in education expenditure in Nigeria is unstable which reflects the instability in government earning. Government revenue was the only significant determinant of education expenditures as revealed by the results of the regression. The study recommends a diversification of the sources of funding education so as to reverse the unstable trend in that sector. Owuoye and Adenuga (2005) investigated the relationship between expenditures on education and health, and economic growth. The study estimated a parsimonious error correction model and found that expenditures on education impacts positively on economic growth. The study recommended that more resources should be channeled towards the level of education where the benefits are higher for the individual and the society at large. The study did not investigate the direction of the link between educational expenditures and economic growth. Babatunde and Adefabi (2005) discovered a long run relationship between human capital development (proxied by schools' enrolments in primary and tertiary institutions and average years of schooling) and economic growth measured by output per worker. Their result showed that education has a statistically significant positive relationship with economic growth. However, they did not give consideration to government health expenditure as a human capital component in the model specified and estimated. Aigbokhan, Imahe and Ailemen (2007) analysed the impact of education expenditures on human Capital development. The study used historical data to establish the correlation between public education expenditure and human capital development in Nigeria and noted that insufficient and uncertain budgetary allocations to education have resulted in the deterioration of its impact on human capital development. Education spending as percentages of annual budgets were low and unstable during the period studied.

Lawanson (2009) took this study further by including both the health and education expenditures in her model. Her objective was to examine the role of human capital investment (proxy by total government expenditure on education and health) on economic growth in Nigeria. After regressing GDP on government expenditure on education, government expenditure on health and the enrolment rates, she found out that a clear relationship exists between human capital development and economic growth. However, unlike the study by Ogujiuba and Adeniyi (2004), the study did not disaggregate expenditure figures on health and education into the recurrent and capital components. Dauda (2010) made use of an adapted endogenous growth model developed by Mankiw, Romer, and Weil (1992) in the study of human capital and economic growth relationship in Nigeria. However, the study did not include government spending as one of the human capital variables used in the model. Oluwatobi and Ogunrinola (2011) in their study examined the relationship between human capital development efforts of the Government and economic growth in Nigeria. It seeks to find out the impact of government recurrent and capital expenditures on education and health in Nigeria and their effect on economic growth. The data used for the study are from secondary sources while the augmented Solow model was also adopted. The dependent variable in the model is the level of real output while the explanatory variables are government capital and recurrent expenditures on education and health, gross fixed capital formation and the labour force. The result shows that there exists a positive relationship between government recurrent expenditure on human capital development and the level of real output, while capital expenditure is negatively related to the level of real output. The study recommends appropriate channeling of the nation's capital expenditure on education and health to promote economic growth. Omojimite (2010) examines the notion that formal education accelerates economic growth using Nigerian data for the period 1980-2005. Time series econometrics (cointegration and Granger Causality Test) were applied to test the hypothesis of a growth strategy led by improvements in the education sector. The results show that there is cointegration between public expenditures on education, primary school enrolment and economic growth. The tests revealed that public expenditures on education Granger cause economic growth but the reverse is not the case. The tests also revealed that there is bi-directional causality between public recurrent expenditures on education and economic growth. No causal relationship was established between capital expenditure on education and growth and primary school enrolment and economic growth. The study recommends improved funding for the education sector and a review of the primary school curricula to make it more relevant to the needs of the Nigerian society. Ernest (2014) examined the likely impact of government expenditure policy on education and the poverty reduction in Nigeria. An integrated sequential dynamic computable general equilibrium model was used to stimulate the potential impact of increase in government expenditure on education in Nigeria. The result of the study indicated that it will be extremely difficult for Nigeria to achieve the MDG target, in terms of education and poverty reduction by year 2015, because the policy measure in his analysis was unable to meet MDG goal. He recommended that in order to achieve the MDG in both education and poverty reduction, investment in education service should receive the highest priority in public investment portfolio. Many of these previous studies reviewed focused on the impact or link between human capital development and economic growth. These works includes the work of Babatunde and Adefabi (2005); Omojimite (2010) and Oluwatobi and Ogunrinola (2011). There also extensive debates on the relationship between human capital investment and economic growth and these were extensively discussed by scholars like Ogujiuba and Adeniyi (2004); Owoeye and Adenuga (2005) and Lawanson (2009). The missing gap here is an assessment of relationship between human capital investment and human capital development.

### 3. METHODOLOGY

#### 3.1. Model Specification

This study seeks to investigate the nexus between human capital investment and human capital development in Nigeria. The theoretical base for this study is augmented Solow human capital growth model. It is Mankiw, Romer, and Weil (1992) that came up with the augmented Solow model a version of endogenous growth theory. The justification for the inclusion of human capital in the model is the fact of non-homogeneity of labour in the production process due to their possession of different levels of education and skills. The model for this study is an improvement on the Solow growth theory, it is therefore specified as:

$$HCD = Af(HCI) \dots\dots\dots 1$$

Where: HCD means Human Capital Development; A means productivity while HCI means Human Capital Investment.

$$HCI = f(EDEXP, HEXP) \dots\dots\dots 2$$

Where: EDEXP means Education expenses while HEXP means Health expenses.  
 Substituting equation 2 into equation 1.

$$HCD = Af(EDEXP, HEXP) \dots\dots\dots 3$$

The expanded model is therefore explicitly stated as:

$$HCD = \beta_0 + \beta_1 TFP_t + \beta_2 EDEXP_t + \beta_3 HEXP_t + \beta_4 LEXP_t + U_t \dots\dots\dots 4$$

Where:

HCD = Human Capital Development (capture by school enrolment)

TFP = Total factor Productivity (measure productivity).

EDEXP = Education expenditure.

HEXP = Health expenditure.

LEXP = Life Expectancy (Stand as control variable).

#### 3.2. Estimation Technique

The study adopts Vector Autoregressive (VAR) method and it's components to analyze the human capital investment and human capital development in Nigeria during the period between 1981 and 2015.

#### 3.3. Sources of Data

This study relied on secondary data. All the data used in the study were sourced through Central Bank of Nigeria Statistical Bulletin 2016 edition and World Bank database with exception of TFP that was generated. TFP used in the study was obtained through direct estimation using non-parametric approach as established by Ajayi, Ekiran and Awe (2012). This is expressed as:

$$TFP = \frac{\Delta y}{y} - 0.35 \frac{\Delta k}{k}$$

### 4. ESTIMATION AND RESULT ANALYSIS

#### 4.1. Time Series Properties of the Variable

The result of the Phillip Peron (PP) unit root test presented in Table 1 showed that Education expenditure (EDEXP), Human Capital Development (HCD) and Health expenditure (HEXP)

are made stationary at their first difference while Total Factor Productivity (TFP) and Life Expectancy (LEXP) are stationary at level and second difference respectively. Since, all the variables are not of the same order of integration, this implies that condition for co-integration is not met. The best alternative suggested by Gujarat and Sangeetha (2007) is to resort to the short – run dynamic estimation using Vector Auto regression (VAR) technique.

*Table 1. Phillip Peron unit root test*

Variables	Level		First Difference		Second Difference		Order of Integration
	P.P Statistics	5% critical Value	P.P Statistics	5% critical Value	P.P Statistics	5% critical Value	
HCD	-0.5322	-2.9571	-3.5459	-2.9571	-----	-----	I(1)
TFP	-3.9343	-2.9571	-----	-----	-----	-----	I(0)
EDEXP	3.5858	-2.9571	-5.1739	-2.9571	-----	-----	I(1)
HEXP	0.5956	-2.9571	-6.5373	-2.9571	-----	-----	I(1)
LEXP	1.7899	-2.9571	-1.9411	-2.9571	-7.8480	-2.9640	I(2)

*Source: Author computation (2017)*

#### 4.2. Vector Auto-Regressive (VAR) Results

*Table following on the next page*

*Table 2. Presents the Vector Auto-Regressive estimates*

Vector Autoregression Estimates

Sample (adjusted): 1983 2015

Included observations: 33 after adjustments

Standard errors in ( ) & t-statistics in [ ]

	EDEXP	HCD	HEXP	LEXP	TFP
EDEXP(-1)	0.849434 (0.82523) [ 1.02933]	-1.02E-05 (0.00011) [-0.09157]	0.787108 (0.58943) [ 1.33537]	8.47E-06 (3.7E-06) [ 2.30475]	-4.79E-06 (8.7E-06) [-0.55194]
EDEXP(-2)	-0.888614 (0.98193) [-0.90497]	-0.000224 (0.00013) [-1.68490]	-0.640214 (0.70135) [-0.91282]	-3.87E-06 (4.4E-06) [-0.88552]	3.81E-06 (1.0E-05) [ 0.36887]
HCD(-1)	71.96089 (1197.74) [ 0.06008]	1.127090 (0.16239) [ 6.94048]	370.0082 (855.502) [ 0.43250]	-0.004183 (0.00533) [-0.78452]	-0.022277 (0.01259) [-1.76890]
HCD(-2)	-1252.995 (1142.25) [-1.09695]	-0.408559 (0.15487) [-2.63808]	-951.8473 (815.866) [-1.16667]	-0.002562 (0.00508) [-0.50390]	0.007843 (0.01201) [ 0.65305]
HEXP(-1)	-0.415510 (1.01846) [-0.40798]	-3.86E-05 (0.00014) [-0.27982]	-0.706878 (0.72745) [-0.97172]	-1.93E-05 (4.5E-06) [-4.25930]	1.34E-05 (1.1E-05) [ 1.25474]
HEXP(-2)	1.116476 (1.64264) [ 0.67968]	0.000349 (0.00022) [ 1.56826]	0.325838 (1.17328) [ 0.27772]	6.44E-06 (7.3E-06) [ 0.88041]	-3.62E-06 (1.7E-05) [-0.20976]
LEXP(-1)	31061.73 (58298.1) [ 0.53281]	18.12694 (7.90423) [ 2.29332]	3224.607 (41640.1) [ 0.07744]	2.030041 (0.25951) [ 7.82245]	-0.552373 (0.61299) [-0.90111]
LEXP(-2)	-2952.233 (62798.8) [-0.04701]	-16.78720 (8.51445) [-1.97161]	26076.45 (44854.7) [ 0.58135]	-0.894669 (0.27955) [-3.20039]	0.477045 (0.66031) [ 0.72245]
TFP(-1)	-15069.92 (21379.8) [-0.70487]	-2.649452 (2.89874) [-0.91400]	-1535.037 (15270.8) [-0.10052]	-0.136323 (0.09517) [-1.43237]	0.041080 (0.22480) [ 0.18274]
TFP(-2)	-368.4245 (24468.9) [-0.01506]	10.30819 (3.31757) [ 3.10715]	9664.729 (17477.2) [ 0.55299]	0.116694 (0.10892) [ 1.07134]	-0.449205 (0.25728) [-1.74595]
C	-1135810. (483484.) [-2.34922]	-29.64593 (65.5522) [-0.45225]	-1267342. (345334.) [-3.66991]	-5.377993 (2.15223) [-2.49880]	5.285053 (5.08370) [ 1.03961]
R-squared	0.942381	0.944325	0.921517	0.998147	0.434662
Adj. R-squared	0.913572	0.916487	0.882275	0.997221	0.151993
Sum sq. resids	1.82E+10	334.8815	9.29E+09	0.360991	2.014083
S.E. equation	30180.41	4.091953	21556.71	0.134349	0.317339
F-statistic	32.71099	33.92272	23.48311	1077.529	1.537709
Log likelihood	-356.9575	-80.87383	-346.5259	25.03271	-1.612835
Akaike AIC	23.73920	5.927344	23.06618	-0.905336	0.813731
Schwarz SC	24.24803	6.436178	23.57502	-0.396502	1.322565
Mean dependent	73333.80	122.7065	41459.38	47.44452	0.091613
S.D. dependent	102659.2	14.15972	62827.25	2.548529	0.344607
Determinant resid covariance (dof adj.)		9.25E+13			
Determinant resid covariance		1.03E+13			
Log likelihood		-684.4310			
Akaike information criterion		47.70523			
Schwarz criterion		50.24940			

*Source: Author computation (2017)*

Based on the results presented in table 4.2, it can be vividly reported that all the variables of interest namely: EDEXP, HCD, HEXP, LEXP and TFP have  $R^2$  values of 94.24%, 94.43%, 92.15%, 99.81% and 43.47% respectively. This confirms that EDEXP, HCD, HEXP and LEXP



are more exogenous than being endogenous variables while TFP is less exogenous. This result suggests bidirectional causality among the variables.

#### *4.2.1. Impulse Response Analysis among Variables*

VAR models are the best method for investigating shocks transmission among variables because they provide information on impulse responses (Adrangi and Allender 1998). An impulse response function traces the effect of one - Standard deviation shocks to one of the innovation on current and future values of the endogenic variables. The accumulated response is the accumulated sum of the impulse responses. The following deductions could be made from figure 1:

1. The response of EDEXP to feedback is positive.
2. The response of EDEXP to HCD is negative.
3. The response of EDEXP to HEXP is oscillating around zero.
4. The response of EDEXP to LEXP is positive.
5. The response of EDEXP to TFP is negative.
6. The responses of HCD to EDEXP, HEXP, TFP and LEXP are very low.
7. The responses of HEXP to EDEXP and LEXP are positive.
8. The responses of HEXP to HCD and TFP are negative.
9. The responses of LEXP to HCD, HEXP and TFP are negative.
10. The responses of LEXP to EDEXP are positive.
11. The responses of TFP to EDEXP, HEXP, HCD and LEXP are very poor.

The summary of the impulse-response analysis above is very clear and simple. It can be inferred that variables are sensitive to one another. Each one responds to shocks in others in a dynamic sense.

*Figure following on the next page*

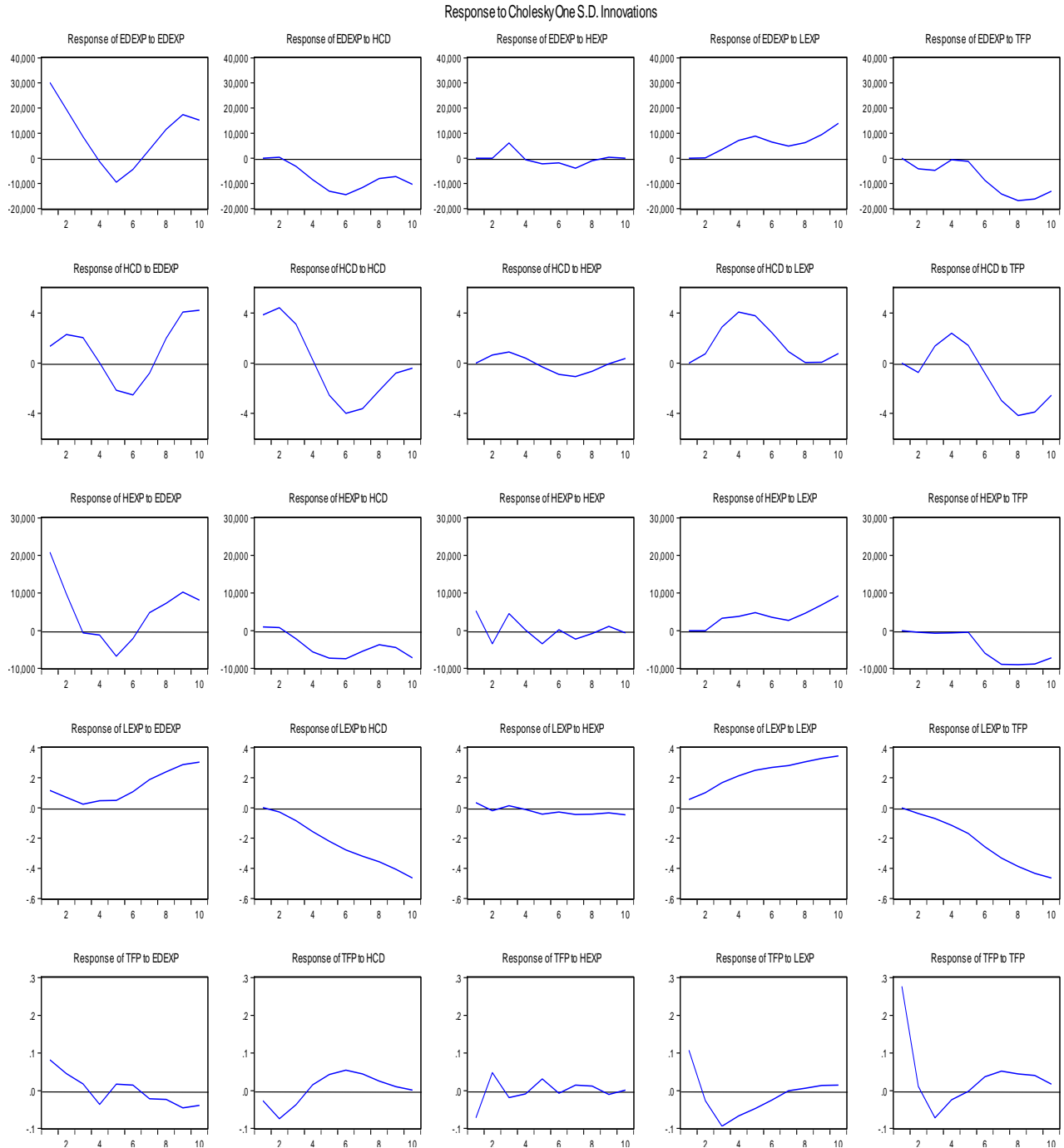


Figure 1. Impulse Response Function.

#### 4.2.2. Forecast Error Variance Decomposition Analysis.

The results discussed under this subsection provide complementary information on the dynamic behavior of the variables. This analysis decomposes the forecast variance into the contributions by each of the different shocks. It shows the proportion of forecast error variance forecast of HCD, EDEXP, HEXP, LEXP and TFP, that is attributing to its own innovation or shock and to shocks in the other endogenous variables. The results of the variance Decomposition are presented in figure 2 below. The following were observed:

- The contribution of HEXP, TFP, HCD and LEXP to EDEXP are very low.
- The contribution of EDEXP, HEXP, TFP and LEXP to HCD are very low.
- The contribution of HCD, EDEXP, TFP and LEXP to HEXP are very low.
- Major source of shock to LEXP is caused by HCD and TFP.

- The contribution of EDEXP, HEXP, HCD, and LEXP to TFP are very low.

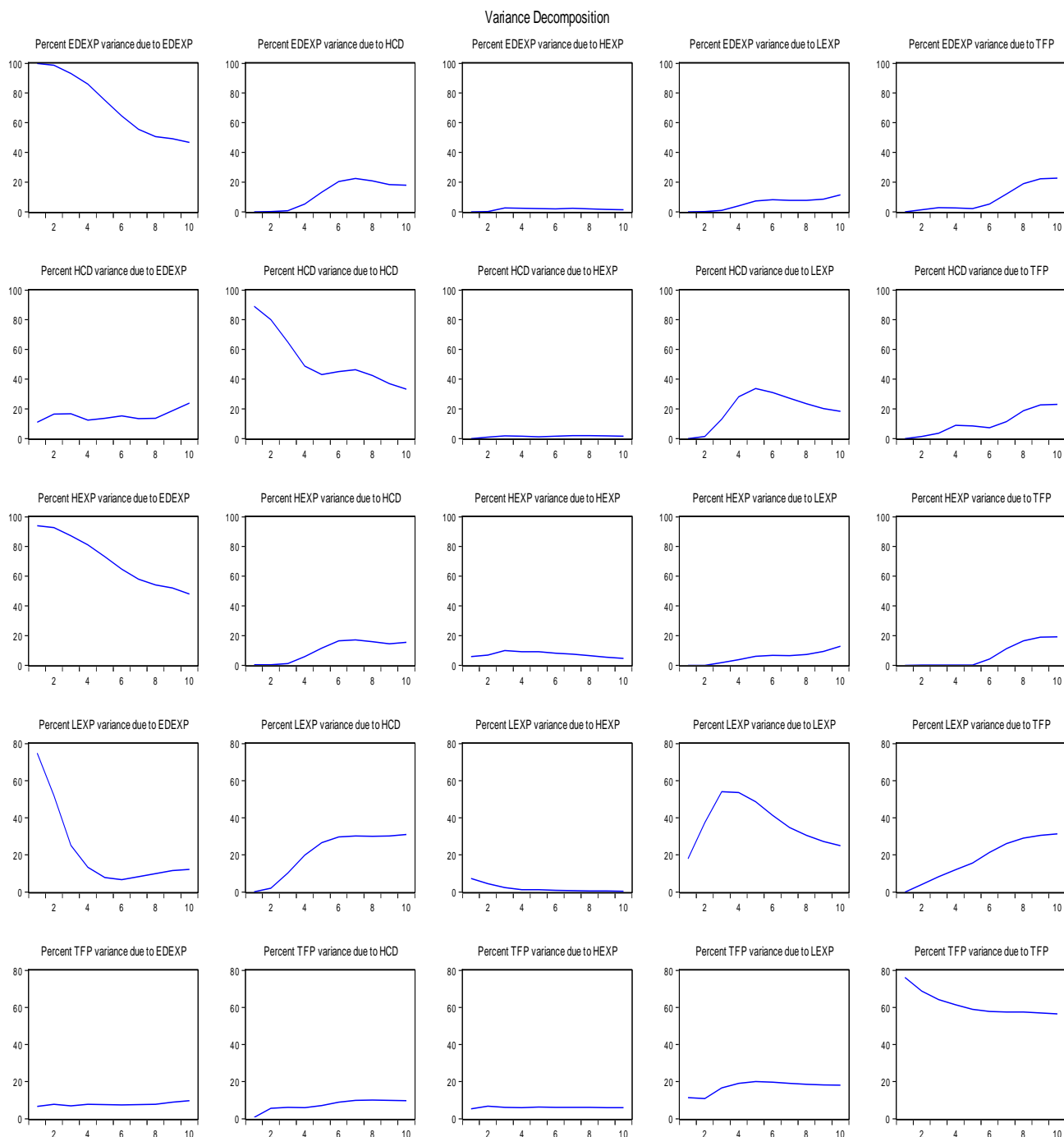


Figure 2. Variance Decomposition

### 4.3. Causality Test

Table following on the next page

*Table 3. Pairwise Granger Causality Tests*

Null Hypothesis:	Obs	F-Statistic	Prob.
EDEXP does not Granger Cause HCD	33	3.29030	0.0532
HCD does not Granger Cause EDEXP		0.10034	0.9049
HEXP does not Granger Cause HCD	33	3.35867	0.0504
HCD does not Granger Cause HEXP		0.00510	0.9949
LEXP does not Granger Cause HCD	33	6.71071	0.0045
HCD does not Granger Cause LEXP		0.51343	0.6044
TFP does not Granger Cause HCD	33	3.54866	0.0434
HCD does not Granger Cause TFP		0.82367	0.4499
HEXP does not Granger Cause EDEXP	33	0.00034	0.9997
EDEXP does not Granger Cause HEXP		0.77477	0.4712
LEXP does not Granger Cause EDEXP	33	4.33431	0.0237
EDEXP does not Granger Cause LEXP		7.13138	0.0034
TFP does not Granger Cause EDEXP	33	0.51116	0.6057
EDEXP does not Granger Cause TFP		0.14495	0.8658
LEXP does not Granger Cause HEXP	33	6.81342	0.0042
HEXP does not Granger Cause LEXP		16.7423	2.E-05
TFP does not Granger Cause HEXP	33	0.20572	0.8154
HEXP does not Granger Cause TFP		0.23667	0.7909
TFP does not Granger Cause LEXP	33	0.23839	0.7896
LEXP does not Granger Cause TFP		1.06686	0.3587

*Source: Author computation (2017)*

From table 3 it is established that causality does not exist between TFP and HEXP. Also bidirectional causality exist between TFP and HCD; LEXP and EDEXP; and LEXP and HEXP. Furthermore, the following unidirectional causality was observed:

- EDEXP granger caused HCD.
- HEXP granger caused HCD.
- LEXP granger caused HCD.
- EDEXP granger caused HEXP.
- TFP granger caused EDEXP.
- LEXP granger caused TFP.

## 5. CONCLUSION

Based on the result and finding so far in the study, the study hereby concludes as follows:

- Education contributes poorly to human capital development. This indicates poor educational funding in Nigeria. This is supported by the studies carried out Aigbokhan et al (2007) and by Omojimiti (2010), they found that insufficient and uncertain budgetary allocations to education have resulted in the deterioration of its impact on human capital development.

- It was also reveals that health expenditure contributes positively to human capital development. This indicates that Nigeria spending on health will improve human capital development in Nigeria. This was in agreement with works of Lawanson (2009) and Oluwatobi and Ogunrinola (2011).
- Life expectancy which show the health situation of the labour force, has reveal from the result has positive impact on human capital development in Nigeria.
- Finally, since Education expenditure and health expenditure capture human capital investment. Therefore, there is causality between human capital investment and human capital development.

## 6. RECOMMENDATIONS

From the findings of this study, it was concluded that human capital investment has impact on human capital development in Nigeria during the period under review. Based on the findings, the following recommendations were made:

1. Concerted effort should be made to improve on both Education and Health spending, by increasing budgetary allocation in that regard, in order to increase human capital development in Nigeria.
2. Government should make appropriate policy that will increase life expectancy of labour force most especially those in education sector of the economy. This will guarantee improvement in Nigeria human capital development.

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## **POLISH LABOR MARKET: ISSUES OF OVER AND UNDEREMPLOYMENT AMONG HIGHLY EDUCATED EMPLOYEES**

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### **ABSTRACT**

*This paper presents the situation of people in the Polish labor market with higher education. Particular attention has been paid to the issues of underemployment (time-related and invisible underemployment) and over-employment. Time-related underemployment occurs when a person would like to work more hours for the same hourly rate, but is unable to do so. Invisible underemployment occurs when employees are over-qualified for their position. There is also overemployment which occurs when an employee works more than the employee expected. Analyzing the extent and consequences of these issues and potential ways of dealing with them are the focus of this paper. The source of the data are the results of a survey conducted among a group of over 900 respondents with higher education. Statistical methods were used. The Polish labor market seems to be very attractive for people with higher education. There is basically no problem of unemployment among highly educated people. This does not mean, however, that such people find work that meets their expectations. Over 15% work less than they would like, and twice as many would like to work less than at present. About 40% work in positions that do not need a college education, which are below their qualifications. Underemployment significantly contributes to achieving lower income than expected (especially time-related underemployment) and to less satisfaction with work. Overtime work, in turn causes fatigue and can negatively affect family relationships, as employees spend less time at home.*

**Keywords:** *higher education, over-employment, underemployment*

### **1. INTRODUCTION**

The primary focus in research and analyses of the labour market has been the problem of unemployment and measuring this phenomenon. Much less attention is devoted to other issues, such as underemployment or overemployment, which are also important factors worth investigating. Therefore, the statistics should be extended to include these concepts to complement the conclusions concerning the labour market. Nowadays, not only the fact of having a job, but also its dimensions or quality has importance. Concepts such as inadequate employment, which results in shortcomings in the labour market, among others things in terms of the amount of work, and an incompatibility between education and professional work (Beyond unemployment..., 2008, p. 2), are raised in this paper using the example of the labour market in Poland. The International Labour Organization (ILO) distinguishes ‘visible’ underemployment from ‘invisible’ underemployment (Husmanns, Mehran, Verma, 1990, p. 121). The first form approximately corresponds to time-related underemployment, and it refers to a situation in which a person is working fewer hours than he/she would like to.

In the ILO statistics, a person who meets the time-related underemployment criteria is indicated as someone who (Budlender, 2011, p.47):

- would like to work additional hours;
- is available to work more hours;
- is working less than a specified working time threshold.

For the purposes of this paper, the definition of Bednarzik (1975), Leppel and Clain (1988) and Jacobs (1993) of underemployment as ‘involuntary part-time employment’ is adopted. In opposition to time-related underemployment, time-related overemployment means a situation in which someone is working more hours than he/she would like to. In turn, invisible underemployment refers to a job requiring lower qualifications or education than is possessed by an employee. This is created by the problem of overeducation, which arises when the higher education sectors produce too many graduates for the labour market to absorb (McGuinness, 2006, pp.399-400). One commonly-accepted theory of overeducation cannot be indicated. Most often, this issue is explained through the theories of the labour market, in particular the Human Capital Theory, Job Competition Model and the Assignment Models (Duncan, Hoffman, 1981, pp. 75-86; Rumberger, 1987, pp. 24-50; Hartog, Oosterbrook, 1988, pp. 185-194; Groot, 1996, pp. 1345–1350; Sloane, Battu, Seaman, 1999, pp. 1437-1453; Dolton, Siles, 2003, pp. 189–217). Time-related underemployment, in turn, is included in the labour supply models, in the context of labour supply flexibility (e.g. Ham, 1982, pp. 335-354; Kahn, Lang, 1991, pp. 605-611; Dickens, Lundberg, 1993, pp. 169-192; Stewart, Swaffield, 1997, pp. 520-535). Researchers have also analysed the causes, consequences (e.g. Leppel and Clain, 1988, pp. 1155-1166; Ruiz-Quintanilla, Laes, 1996; Wilkins, 2004) and the trends of visible underemployment (e.g. Bregger, Haugen, 1995, pp. 19-26; Sorrentino, 1995, pp. 31-50). The phenomena of under- and overemployment are also explained in the context of the asymmetric information in labour contracts (Azariadis, 1983, pp. 157-172; Green, Kahn, 1983, pp. 173-187; Cooper, 1983, pp. 81-87; Hart, Ma, 2010, pp. 170-179). In Poland, there have been few papers dealing with the problem of underemployment or overemployment. In this paper, the first results of surveys conducted among highly-educated people (aged 25-45) in the Polish labour market are presented, with the use of a broader concept of labour underutilisation and an estimation of the size of its various components.

## 2. METHOD AND DATA SOURCES

In this paper, data from secondary sources is used: the ILO database and Labour Force Survey (LFS), and the results of empirical research. The empirical data used in this paper comes from research carried out using the CAPI<sup>1</sup> method, on a nationwide sample of Poles that had completed higher education and covering a cohort of graduates with a Bachelor's degree or higher (aged 25-45). The study was carried out on a random-quota nationwide sample. 902 interviews were carried out among 542 women and 360 men during the period of November–December 2016. The data was collected from three cross-sections of respondents, representing those that received education at different stages of the transformation in Poland. In connection with this, the sample group divided into three sub-groups:

- Subgroup A: respondents aged 39-45 (301 interviews)
- Subgroup B: respondents aged 32-38 (300 interviews)
- Subgroup C: respondents aged 25-31 (301 interviews)

In determining the results, statistical methods were applied – primarily descriptive statistics.

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<sup>1</sup> Computer-Assisted Personal Interviewing



### 3. INADEQUATE EMPLOYMENT IN POLAND – SURVEY RESULTS

There is no unemployment problem in Poland among people that have succeeded in higher education: according to the LFS reports, in the fourth quarter of 2016, the unemployment rate among highly-educated people amounted to 3%, with the total unemployment rate in this period at the level of 5.5%. Persons with higher levels of education are also characterised by the highest activity rate at 80.2% (in total 56.3%) and the highest employment rate at the level of 77.9% (in total 53.2%) (LFS, 2017, p. 117). Only 7% of the respondents remained without work, of which only 1/5 were unemployed persons and half indicated taking care of a child or a home as a reason for this professional inactivity. The divisions of non-working people according to the reasons are presented in Chart 1.



Chart 1: Non-working persons that have completed higher education (aged 25-45) according to the reason for professional inactivity (own calculations)

#### 3.1. Time-related over- and underemployment

Although the vast majority of people with higher levels of education were employed, only slightly more than half of them were satisfied with their current working times. This means that the working times in Poland are not very suitable for the employees. Chart 2 presents the preferences of the employees regarding working times.

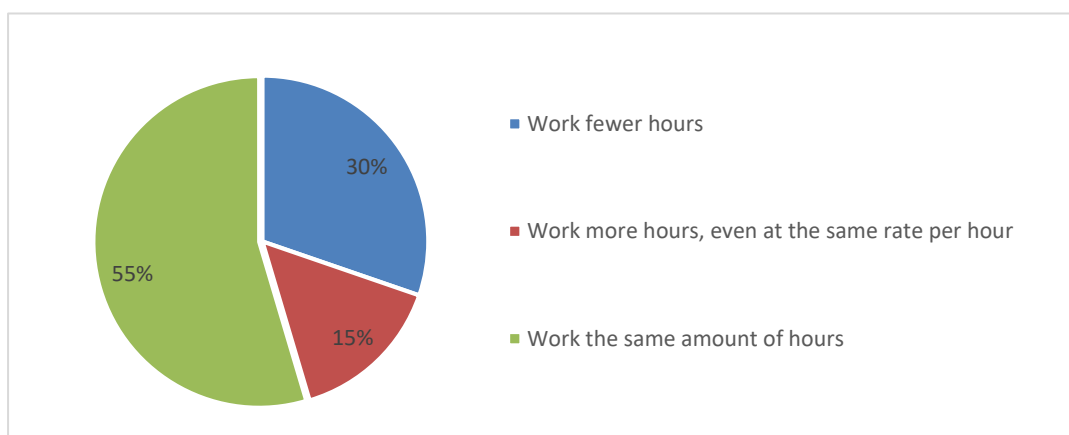


Chart 2: Preferred length of the working times among highly-educated employees aged 25-45 (own calculations)

Thus, 30% of the employees are overemployed, while 15% are underemployed. Table 1 shows the share of under- and overemployed individuals broken down by gender and employment status.

*Table 1: Persons with higher levels of education (aged 25-45) who want to work more hours and persons who want to work fewer hours, broken down by gender and employment status (in %) (own calculations)*

	Underemployed		Overemployed	
	Females	Males	Females	Males
	15 (0.04)	15 (0.04)	29 (0.04)	32 (0.05)
Employment status				
Full-time	12.5 (0.05)	11.7 (0.05)	29.6 (0.04)	33.1 (0.05)
Part-time	36.4 (0.11)	41.7 (0.13)	27.3 (0.12)	19.4 (0.16)

*Notes: Standard errors are indicated in parentheses.*

*Underemployed: A person with a marginal or greater attachment to the labour force that wants more hours of work.*

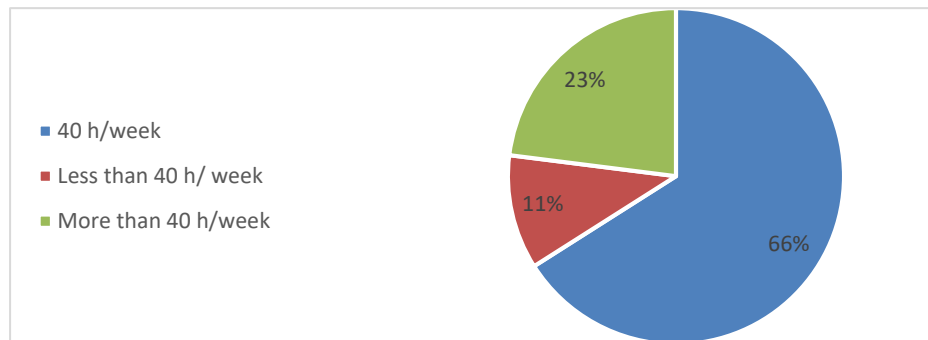
*Overemployed: An employed person that wants fewer hours of work.*

As might be expected, underemployment is primarily associated with part-time employment, while overemployment is associated with full-time employment. However, while the scope of underemployment is similar with regard to gender, overemployment affects men to a greater extent than women. Significantly, in the case of part-time employment, males are more likely than females to prefer more hours, while females are more likely than males to prefer fewer hours. What's interesting is that the opposite situation occurs in the case of full-time employment. When it comes to working hours, it is important to be aware that in Poland, employees work on average more hours per week than in other EU countries. The average number of working hours for Polish employees was 41 hours per week in 2016. On a global scale, this is not a significant result, but it is the highest in the EU (along with Greece). Table 2 shows the average number of working hours in the European Union countries. The result is also of one of the highest among the highly developed countries. As research shows (Dembe, Erickson, Delbos, Banks, 2005, pp. 588-597), overworking can be dangerous for an employee, exposing him to accidents at work and illness.

*Table 2: Mean weekly hours per employed person in EU countries in 2016 (ILOSTAT, 2018)*

	Country	Mean weekly hours/ employed person		Country	Mean weekly hours/ employed person		Country	Mean weekly hours/ employed person
1	Greece	41	11	Estonia	39	21	Finland	36
2	Poland	41	12	Croatia	38	22	Sweden	36
3	Bulgaria	40	13	Portugal	38	23	United Kingdom	36
4	Czech Republic	39	14	Malta	38	24	Ireland	36
5	Latvia	39	15	Cyprus	38	25	Austria	36
6	Hungary	39	16	Luxembourg	38	26	Germany	36
7	Romania	39	17	Belgium	37	27	Denmark	34
8	Slovenia	39	18	Spain	37	28	Netherlands	32
9	Slovakia	39	19	Italy	37			
10	Lithuania	39	20	France	36			

The working rate of 40h per week is most dominant in Poland, and the majority of employees work at this rate. However, almost 1/4 of the labour force works above this rate. Chart 3 shows the overall working hours in Poland.



*Chart 3: Working hours per week among highly-educated employees aged 25-45 (own calculations)*

The people who want to work less (overemployed) work on average 2 hours a week more than the majority, and 4 hours more than the people who would like to work more (underemployed). On this basis, it can be concluded that the optimal working time in Poland is 40h per week, which is exactly as much as a full-time job in most professions. Almost 2/3 of the people that have finished higher education are working exactly 40 hours a week, and of these 25% want to work shorter hours, 16% want to work longer hours and 59% want to work the same amount. The study did not verify the possibility of working additional hours by the respondents. Therefore, it was only possible to estimate the scale of the underemployment based on the respondents' declarations regarding the desire to increase the number of working hours. Underemployment can be measured by either headcount measurements (number of persons underemployed) or volume measurements (number of hours of underemployment). The research conducted in this instance did not provide a reliable answer to the volume of the underemployment, and for this reason only the first method of measuring underemployment was used in the paper.

### **3.2. Overeducation (overeducated and overskilled employees)**

The scale of overeducation in Poland is not too high in comparison with the other EU or OECD countries (see OECD, 2015, p.10)<sup>2</sup>; however, it may deteriorate along with the growing level of education among Poles. About 40% of highly-educated Poles currently work below their level of education. Table 3 presents the extent of overeducation divided into the fields of study.

*Table following on the next page*

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<sup>2</sup> Data from 2011-2012

*Table 3: The extent of overeducation among highly-educated employees aged 25-45 by the field of study (own calculations)*

Field of study	Overeducation (formally)	Overeducation (actually)
Humanities (excluding Law)	35.3 (0.04)	36.9 (0.04)
Law	17.7 (0.10)	17.7 (0.10)
Medicine	31.6 (0.08)	31.6 (0.08)
Social Sciences (including Pedagogical Studies, but excluding Economics)	32.8 (0.04)	33.6 (0.04)
Economics	33.1 (0.03)	35.5 (0.03)
Arts	69.2 (0.13)	76.9 (0.12)
Technical	48.0 (0.04)	49.5 (0.04)
Natural and Agricultural Sciences	42.9 (0.08)	45.7 (0.09)
Other (e.g. Physical Education)	66.7 (0.10)	66.7 (0.11)
Total	39.4 (0.02)	41.5 (0.02)

*Notes: Standard errors are indicated in parentheses.*

*Overeducation (formally): Based on the respondent's recorded answer to the question 'What was the minimum level of education required in hiring a candidate for your job?' (where an employee was considered as overeducated if the level of education indicated was lower than the achieved higher education).*

*Overeducation (actually): Based on the respondent's recorded answer to the question: 'What is the minimum level of education actually needed for the position you occupy?' (where an employee was considered as overeducated if the level of education indicated was lower than the achieved higher education).*

The least overeducated group of employees was the people with a Legal education, while the most overeducated were those with an Artistic and Other education (e.g. Physical Education). A Technical education did not give the employees in Poland a greater chance to utilise the educational background in their work. Almost half of the employees with such an education were working below the level of their qualifications. What's more, the biggest discrepancies between the formal requirements for education and the actual qualifications needed were observed by the employees with an Artistic education (7.7 pp), whereas there was no such discrepancy among the employees with a Legal, Medical and Other education (e.g. Physical Education). The results obtained for Poland are partly convergent, and partly deviate from the results obtained by the researchers from other countries (see Dolton, Vignoles, 2000, pp. 179-198; Frenette, 2004, pp. 29-45; García-Montalvo, Peiró, 2009). They have pointed to a higher level of overeducation among people that have completed qualifications in the fields of the Arts and Humanities, but at the same time the lowest rates were achieved for those educated in Law, Medicine and Technical Studies. In the fields of Social Sciences and Economics, the research results differed significantly in various studies. This problem is therefore quite significant and requires further exploration. Another interesting aspect is that of gender and overeducation. The range of overeducation, broken down by gender, is presented in Table 4.

*Table 4: The incidence of overeducation among highly-educated employees aged 25-45 by gender (own calculations)*

Gender	Overeducation (formally)	Overeducation (actually)
Females	36.8 (0.04)	40.3 (0.04)
Males	43.0 (0.04)	43.3 (0.04)

*Notes: Standard errors are indicated in parentheses.*

From this, it can be seen that women work below their education level less often than men. However, the difference between the sexes is definitely greater with respect to formal (6.2 pp) than to actual overeducation (3 pp).

#### 4. OUTCOMES ASSOCIATED WITH OVEREMPLOYMENT AND UNDEREMPLOYMENT

When work does not fit the employee's needs and expectations, this can affect many aspects of a person's life, including the sense of satisfaction with the job itself, but also other aspects of life, health, family and friend relationships, etc. It also plays an important role in terms of the person's income and living standards. The aim of this part of the study is to indicate some of the potential effects that can be related to inadequate employment. This was undertaken by presenting the descriptive statistics for selected variables that can be loosely interpreted as reflecting the outcomes experienced by the respondents. Descriptive comparisons of the underemployed workers with both the overemployed and fully employed workers, but also with the overeducated workers, are presented in Table 5.

*Table 5: Outcomes of overemployment and underemployment for overemployed and underemployed highly-educated employees aged 25-45(own calculations)*

	Fully-employed		Underemployed		Overemployed		Overeducated	
	Females	Males	Females	Males	Females	Males	Females	Males
Life satisfaction	4.14 (0.04)	4.01 (0.05)	3.63 (0.09)	3.61 (0.12)	3.84 (0.06)	3.98 (0.07)	3.80 (0.1)	3.86 (0.11)
Job satisfaction	3.93 (0.05)	4.04 (0.06)	3.19 (0.1)	3.25 (0.13)	3.59 (0.08)	3.83 (0.08)	3.34 (0.11)	3.65 (0.13)
Financial situation	3.66 (0.05)	3.61 (0.06)	3.4 (0.1)	3.51 (0.12)	3.34 (0.08)	3.5 (0.1)	3.32 (0.11)	3.32 (0.14)
Wealth	3.22 (0.05)	3.15 (0.05)	2.91 (0.11)	3.02 (0.14)	3.06 (0.07)	3.13 (0.07)	2.89 (0.15)	2.95 (0.17)
Personal income	2776 (75)	3385 (131)	3143 (210)	3195 (254)	2905 (142)	3427 (219)	2674 (226)	3437 (400)

*Notes: Standard errors are indicated in parentheses.*

- *Life satisfaction: The respondent recorded a score from 1 (completely dissatisfied) to 5 (completely satisfied) in response to the question ‘How satisfied are you with your life?’*
- *Job satisfaction: The respondent recorded a score from 1 (completely dissatisfied) to 5 (completely satisfied) in response to the question ‘How satisfied are you with your job?’*
- *Financial situation: The respondent recorded a score from 1 (completely dissatisfied) to 5 (completely satisfied) in response to the question ‘To what extent you are satisfied with your financial situation?’*
- *Wealth: The respondent recorded a score from 1 to 5 in response to the question ‘How would you rate the level of your wealth compared to that of the total population in your city?’, where 1 was the lowest and 5 the highest level.*
- *Personal income: The respondent's personal monthly net income in PLN*

By comparing the groups of employees presented in the table, it is easy to notice that the weakest results are found among the underemployed employees. In turn, the life situation is best perceived by the group of people who are working exactly as much as they want (fully employed). The overeducated group is not a separate group in relation to the others, but only represents an attempt to extend the analysis by including this aspect. All of the people classified as overeducated are simultaneously included in one of the other three groups. The results in selected aspects are similar (with some advantage for the overemployed) for the overeducated

and overemployed groups. Most of the results in a given group (all for the overemployed and overeducated) reached higher values for men than for women. What is striking is the relatively good (compared to the others) income and financial situation of the underemployed woman, and it is difficult to explain this phenomenon solely on the basis of the available data. Being overeducated can affect the perception of one's wealth compared to that of others – and this index is even lower than the result for those who are unemployed. One of the possible explanations for this result may be a sense of unused opportunities. But conducting further analyses is required in order to draw such conclusions. For women, overeducation is associated with a lower income, but for men there is no such regular outcome. Perhaps the income earned by men is more related to the amount of work performed, while in women it is related with the occupied position.

## 5. CONCLUSION

The average length of the working hours in Poland does not differ significantly from the international labour standard (40h per week) (ILO Convention No. 47 of 1935); however, a significant part of the Polish work force would like to reduce their working time. The Polish labour market has improved significantly in recent years (which is manifested, inter alia, by the constantly falling unemployment rate). In particular, people that have completed higher education have no difficulty in finding a job. However, the expectations of Poles have followed the development of this market and appear to be close to the expectations of employees from Western Europe. More and more educated Poles seem to be placing a greater value on their free time and the opportunity to pursue their interests also outside of work. The issues surrounding inadequate employment are very important because they affect a significant part of the nation's employees. 45% of highly-educated employees are not working for the time they would like and 40% are not using their qualifications. The over- and underemployment issues therefore require further research. In future labour market statistics, it is necessary to take into account, in addition to the lack of work, its quantity and its quality as well as its compliance with the expectations and ambitions of the employees. The biggest problem in the Polish labour market seems to be both visible and invisible underemployment; that is, many employees are working fewer hours than they expected or are working below the level of their education or qualifications. The first form of underemployment may lead to lower satisfaction with work and life, and to a lower income and level of life satisfaction; whereas the second form also leads to a lower subjective assessment of one's wealth. The progression of 'scholarisation' and the increasing levels of education among Poles requires that this issue be addressed in the first place. However, an adaptation may be required to address not only higher education but also vocational education (which has been subject to sharp criticism in recent years). There should be independent information about the situation of the labour market that is regularly produced and disseminated, to help young people make decisions about their education investments.

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## CIVIL LAW PROTECTION FROM EMISSIONS IN THE CASE OF LANDFILL

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### ABSTRACT

*According to numerous data, Split has become a tourist centre. Countless cruise ships dock here and the world renowned Ultra music festival has been held here for years now. Tourism has developed to the extent that people started to move out of their homes (at least during summer months) and stay with their families in order to rent their apartments to tourists. One of the most important components for economy of a country is precisely tourism. In the last few months, Split citizens have been faced with the rehabilitation of the largest landfill south of Zagreb, Karepovac in Split. Due to the rehabilitation in Split, especially when the wind blows, there is an unbearable stench. The smell is so strong that in certain parts of the city people must wear protective masks on their face. The legal framework in a regulated state must contain a solution for such situations. This means determining who is entitled to request that such a situation be disrupted and / or to compensate for the damage as well as deciding who is entitled to compensation. In conclusion- who will pay for all of it? Formally in the foreground is the municipal utility company and, consequently, its founders. However, the Republic of Croatia cannot be released from responsibility, because its bodies formally forced the City of Split and Karepovac to accept garbage from a number of other municipalities and cities, despite the opposition of the utility company and the City of Split. The aim of this paper is to analyse the solutions in the Croatian legal framework de lege lata, in particular the Ownership and Other Rights in Rem Act and the Civil Obligations Act and de lege ferenda to provide suggestions where necessary and to encourage discussion on this topic among others in order to analyse the situation in their countries. If there is place for prognosis, this whole case would probably represent a "cash cow" for Croatian lawyers, but also a huge burden on the judiciary system.*

**Keywords:** *civil law aspect, economics, emissions, landfill, tourism*

### 1. INTRODUCTION

Emission protection, environment protection and ecology in general are the narrowest circle of topics on a global level, not only from the legal aspect, but from any aspect as well. It is enough to mention, for example, Green Peace as a globally known association that takes care of environment around the world (often risking life and health of volunteers), at the same time fighting the (rather unequal<sup>1</sup>) battle with multinationals and other corporations (which, fighting for profit often pay too little attention to ecological damages which are at least potentially peculiar to many entrepreneurial activities, especially those industrial) so that everyone knows what it is about. There are also many international conventions that have their focus on environmental protection, but unfortunately they are most commonly present in the media when a major accident occurs or when a country (even more if it is a “superpower”) decides to retreat from one of the conventions (the most known of which probably UN Framework Convention on Climate Change 1992., Protocol 2007. Kyoto related to the fact that Donald Trump as the newly-elected US president announced the resignation of Kyoto as one of the first measures he took). All this is apparently linked to the current events in Split, the second city in both size and significance in the Republic of Croatia, the events that made the city of Split, known for

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<sup>1</sup> Often on the opposing side stands power measured in billions of dollars, often higher than the average state

numerous beautiful things, now famous for its waste, rubbish and unbearable unpleasant smell (stench), in other words, we now have Split - "Karepovac Case"<sup>2</sup>. Leaving to other professions to deal with this problem from other aspects, we have decided to investigate the problem from the aspect of the existing legal framework, particularly the application of two key acts that contain legal norms that authorize to a reaction against emissions - The Ownership and Other Rights in Rem Act<sup>3</sup> and the Civil Obligations Act<sup>4</sup>. Of course, if the research shows the need, then the proposal of *de lege ferenda* will follow. Thus, we decided to check the Croatian<sup>5</sup> legal framework on the so-called "Karepovac Case", a case that many describe as the scandal of the decade (at least), which can still be limited to the level of a very serious warning, but can (easily) turn into a real catastrophe of an immense range.

## 2. LEGAL SOURCES

When looking at the state of the legal framework (both domestic and international) regarding the landfill, the situation looks quite good. Among international acts we can mark off the Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (Basel, 1992)<sup>6</sup>. Of the European Union acts, we can list Regulation (EC) No. 1013/2006 of the European Parliament and of the Council of 14 June 2006 on shipments of waste, Commission Regulation (EC) No. 1418/2007 of 29 November 2007 on the export of certain waste intended for use specified in the Annex III. or III.A Regulation (EC) 1013/2006 of the European Parliament and of the Council in certain countries to which the OECD Decision does not apply about control of transboundary movement of waste and Commission Implementing Regulation (EU) 2016/1245 of 28 July 2016 setting out a preliminary correlation table between codes of the Combined Nomenclature provided for in Council Regulation (EEC) No 2658/87 and entries of waste listed in Annexes III, IV and V to Regulation (EC) No 1013/2006 of the European Parliament and of the Council on shipments of waste (SL L 204, 19.7.2016). European directive which binds the closure of landfills such as Karepovac by the end of 2018<sup>7</sup> is also important. Of the domestic legal sources we can distinguish the Constitution of the Republic of Croatia<sup>8</sup>, the Act on Sustainable Waste Management<sup>9</sup>, and the Waste Management Strategy of the Republic of Croatia<sup>10</sup>. Of course, given that in this paper we are dealing with waste in the context of civil law protection from emissions, The Ownership and Other Rights in Rem Act and the Civil Obligations Act are also legal sources.

## 3. PROBLEM ANALYSIS DE LEGE LATA AND DE LEGE FERENDA

### 3.1. Factual Condition

Waste is something that used to be solved practically by itself and nobody was particularly burdened by it. Since over time we as a society in whole have become increasingly aware of the limited resources we have to keep if we want to ensure the survival of mankind, activities of the legislator over the creation of the legal framework have become more intense as well as

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<sup>2</sup> Karepovac is the official name of the Split landfill, which has long since exceeded its capacity but keeps on piling, and what makes it more absurd, with garbage of many other Dalmatian cities.

<sup>3</sup> Ownership and Other Rights in Rem Act, official gazette Narodne novine NN 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.

<sup>4</sup> Civil Obligations Act, official gazette Narodne novine 35/05, 41/08, 125/11, 78/15, 29/18.

<sup>5</sup> Given the EU membership, the Croatian legal framework is also the European legal framework and vice versa.

<sup>6</sup> Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (Basel, 1992), Published in official gazette Narodne Novine - International Agreements 3/94. It entered into force with respect to the Republic of Croatia on 7th August 1994.

<sup>7</sup> It is already clear now that this deadline can not be met.

<sup>8</sup> Constitution of the Republic of Croatia, official gazette Narodne novine 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14.

<sup>9</sup> Act on Sustainable Waste Management, official gazette Narodne novine 94/13, 73/17.

<sup>10</sup> Waste Management Strategy of the Republic of Croatia, official gazette Narodne novine, 130/05.

activities on how to act within this legal framework. Karepovac (by far the largest landfill south of Zagreb), the name and concept that threaten to become one of the biggest symbols of Split, along with St. Dujice, Diocletian's Palace, Riva, Marjan, Jugoplastika, Hajduk and Goran Ivanišević etc. This is a very important topic for everyone, and yet especially for entrepreneurs who are in our focus. Since January 2018, on the beach Žnjan (which is one of the most famous beaches in Split along with Bacvice, a place visited by Pope John Paul II who held a mass there in front of hundreds of thousands of people) unpleasant odors often make the stay there unbearable, and everything only gets drastically worse in Solin and the area of Split that is closer to Karepovac than Žnjan. Of course, everything depends on which wind is blowing (southern is a complete disaster for Solin, the northern wind is a problem for Žnjan). The cause of this "disaster" is) about 5 km distant Karepovac landfill (calculating from Žnjan, where rehabilitation is currently in process. According to officially published data, the ammonia concentration exceeded the hourly limit values of 100 micrograms per cubic meter (at midnight on 25th January to 26th January, it was measured at 128.20) and mercaptans<sup>11</sup> reached 4.61 micrograms per cubic meter while the limit value was 3<sup>12</sup>. In Solin (significantly more exposed to danger than Split), many people walk around with gas masks on their faces<sup>13</sup>, and a very unpleasant smell enters the cars even if the windows are completely closed. Both large hospitals in Split (Firule and Križine) are at risk (with all the patients and visitors and employees) who are unable to open windows and ventilate rooms (because it would be worse than before ventilation), and particularly large apartment buildings (socially stimulated construction) which are at „ground zero“ as well as a large shopping center in the immediate vicinity. This situation<sup>14</sup> has been going on for months now, and one should only hope that the announcement is true that by the end of May the first phase will have been completed and that it will be significantly better afterwards. According to numerous relevant sources and data, just a couple of years ago Split finally ceased to be merely a transit tourist center where tourists mostly stay for a few hours, now tourists come to stay for days and use Split as a base for their excursions to Plitvice, Dubrovnik, Hvar and beyond, there are cruise ships which dock here now (massively) with thousands of tourists, for years Ultra Festival has been held here, a global phenomenon which brings several hundreds of thousands visitors from all over the world within one week (because of which the citizens of Split, during the Festival, start to rent their apartments in the town center and move to their cousins or friends in the suburbs or even in the countryside, even the one who usually do not rent apartments), here the tourist season of 45-60 days of duration is ancient history now (most of the owners who rent to tourists have closer to 200 than to 100 overnight stays<sup>15</sup>). It is almost a rule that everyone interested in getting anywhere (Split included) follow the situation carefully online and via all media so the number of those who have missed the events in Split regarding Karepovac is not so high.

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<sup>11</sup> Thiols (sulfur + alcohol, thioalcohols) are organic compounds, sulfur analogue alcohols of the general formula R-SH (R = alkyl group). The older and abandoned name for thiols is mercaptan (germ. merkaptan <medieval. lat. [corpus] mercurium captans: [the one] who catches mercury), has pointed out their ability to react with mercury (and its compounds) and form salt easily to give insoluble organosynaptic compounds of mercaptide (eg by reaction of ethanethiol with the mercury oxide (CH<sub>3</sub>CH<sub>2</sub>S)<sub>2</sub>Hg). These are mostly evaporative liquids, with intense and repulsive smelly fragrances, found in oil, and are also present in the proces of decomposition of sulfur-containing proteins. They easily oxidize into disulfides, which is important in oil refining. Source: wikipedia, <https://en.wikipedia.org/wiki/Thiol>, downloaded 29.03.2018 at 18.35.

<sup>12</sup> Source: Slobodna Dalmacija from 27.01.2018., p. 16.

<sup>13</sup> In the immediate vicinity of Karepovec (unfortunately, there are many residential buildings) almost everyone walks around with their masks on.

<sup>14</sup> Which is unfortunately getting worse, or at least is not getting better, even though the media pressure resulted in spraying measures that should neutralize or reduce odors.

<sup>15</sup> Those who are absolutely harmed are students who (if they do not have accommodation in student homes) cannot virtually rent an apartment or room for a year, the practice is that they must leave the property no later than May 1st and they can not move before October 15th of the year.

Given that tourists choose freely where to spend their own money, it is clear that any negative information potentially threatens tourism – in other words, smaller the number of tourists, smaller the income, consequently the profit is lower not only to those who directly deal with renting accommodation facilities<sup>16</sup> (rooms, apartments, hotels), but also to all those who have or might benefit from it indirectly (e.g. tourists clearly spend their money in restaurants, shops, using public transport, mechanic services, etc.). On the other hand, it is obvious that many who would otherwise come to Split or those who were choosing between Split and one or more locations will now, because of the Karepovac unpleasantness, have to give up Split (at least for this year). Should fewer tourists come, the reduced profit certainly represents damage, and liability for damages exists if other legal requirements are met. The existence of any rights that may compel the one expanding emissions (in this particular case the unpleasant smells) to an orderly behavior should be investigated.

### 3.2. Legal frame

If a smaller number of tourist would come, the reduced profit without a doubt represents damage and if other legal terms are realized then liability for damages is present. What remains to be investigated is if there are rights which can force the one spreading emissions (in this exact case the unbearable stench) to an appropriate behavior. Emissions generally are the impacts that gaseous, solid or liquid substances have on the environment, and when it comes to property they are defined as impacts that gaseous, solid or liquid substances coming from one property have on the use of the neighboring property<sup>17</sup>. By another definition, these are physical disruptions that come from one property and hinder the service or use of another property, which may include smoke, unpleasant smells, noise, waste water, and so on<sup>18</sup>. It is highly important to note that the Ownership and Other Rights in Rem Act in art. 110 describes emissions providing examples (and not in a taxative manner) by stipulating "... smoke, unpleasant smells, soot, waste water, earthquakes, noise, and so on.". This means that the list is not closed but that smoke, unpleasant smells, soot, waste water, earthquakes, noise are listed as the most common or most obvious cases and no one can dispute that they are emission and rightly so. The legal standard „and so on“ needs to be filled with content by interpretation methods and answer the concrete question of whether or not something is an emission (e.g. excessive heat streaming around, for example, a burning boiler- we are convinced that it is also an emission). Civil Obligations Act in art. 1047, paragraph 1 is even more general and more imprecise in its formulation "... a major source of danger for him or for another person, as well as to refrain from activities causing disturbance or a risk of damage...". It is also important to note the division of emissions to those direct or immediate, and indirect or mediate, which is a division by mode of transmission. Emissions transmitted by special devices or directly in any other way are immediate, the other mediate ones – therefore are in process without the direct influence or will of the one from whose property they are being transmitted, they are natural forces (wind, pressure, slope ...) or incidence. Direct emissions are generally prohibited, while with the indirect emissions it depends on the various criteria (most often, if anything is exceeding, but also the type and size of the damage). In the Croatian legal framework we can outline two acts that are obviously violated by the described event at Karepovac, as well as all similar events. The first one is the Ownership and Other Rights in Rem Act and the other one the Civil Obligations Act. Both acts, like any other, have their foundations in the Constitution of the Republic of Croatia, according to which everyone is entitled to a healthy environment. Thus, the violation of this right is unlawful in itself, which means that every legal entity (not

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<sup>16</sup> It can be a single room, apartment, hotel ....

<sup>17</sup> Petar Klarić, Martin Vedriš, Civil Law, Narodne Novine, Zagreb, 2014., p. 241st

<sup>18</sup> Nikola Gavella, Tatjana Josipović, Igor Gliha, Vlado Belaj, Zlatan Stipković, Right in Rem, Volume 1, Narodne Novine, Zagreb, 2007, p. 662.

only natural persons, but also all legal persons - commercial societies and associations in the first place) may be harmed by unlawful conduct. It is not an issue that the unpleasant smells from Karepovac are emissions and that they cause harm (by definition the harm is diminution of one's property, prevention of its increase and the violation of personal non-material goods - the violation of personality rights). Nor is it an issue and that the rehabilitation of Karepovac is carried out on the basis of appropriate permits. It should also be emphasized that the Ownership and Other Rights in Rem Act calls these emissions indirect emissions. According to art. 110 of The Ownership and Other Rights in Rem Act it is clear that every owner or co-owner of a property (presumed owners should also be included, i.e. those who may not have the conditions to apply actio negatoria but have them for its public version<sup>19</sup>) has the right to ask:

- to eliminate the causes of the emissions and to compensate the resulting damages, as well as to
- not to do in the future on his real property what was the cause of the excessive emissions until he takes all measures required to eliminate the possibility of excessive emissions.

Considering the existence of a permit (no one is carrying out the rehabilitation of Karepovac arbitrarily<sup>20</sup>), the owners of properties exposed to emissions do not have the right, as long as the permit is valid, to require disruption in performing this activity, but are therefore authorized to demand compensation for damages caused by emissions, as well as to take appropriate measures to prevent excessive emissions in the future, or the presence of damage, or to diminish it. From the above it could be concluded that the one who is not the owner of the property has no legitimacy to seek anything. This is the case only in respect to the Ownership and Other Rights in Rem Act. However, this is where another regulation assists, the Civil Obligations Act, according to which (Article 1047): „Any person may request from another person to eliminate a major source of danger for him or for another person, as well as to refrain from activities causing disturbance or a risk of damage, if disturbance or damage cannot be prevented by applying the appropriate measures.“ However, there is a corrective provision according to which „If damage is a result of performing an act of public interest for which an approval has been obtained from the competent authority, only a compensation for damage exceeding the usual limits may be required (excessive damage).“ In this case, too, undertaking socially justified measures to prevent or reduce the damage can be petitioned. As aforementioned, applied in a concrete case (in concreto) means that virtually every citizen of Split (but also Solin) is entitled to seek protection from the emissions from Karepovac and compensation for damages, whether it is a proprietary or a legally binding claim. Numerically presented, this is a number of over 200,000 people, to which legal entities should be added. When we analyze what the damage would be, actual damage in terms of diminishing the existing property would probably be the least likely consequence (since these emissions of such range are still of limited duration, at least we hope this is the case). It is completely different when it comes to lost profit. In an era of technological revolution, when the world is nothing but a big global village, a simple "click" on the computer gives you all the information and everyone knows that the current situation with emissions is bad and that (taking into consideration that few deadlines are ultimately met here) it should be significantly better by the summer, but if the deadline is met and the situation is better then, it will probably be too late for destination decision making. This is a huge financial loss for many businesses. E.g. everyone who offers tourist beds has every reason to fear, even panic (and there are over 30,000 beds available in Split alone). However, there are all those who are part of the tourist service, who objectively depend on the fact that tourists come to Split (usually renting a room, apartment etc.) - restaurants, boats,

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<sup>19</sup> Nikola Gavella, Tatjana Josipović et alt., p. 664.

<sup>20</sup> It is an entirely different matter how accurate these permits are, and how precise and frequent the control is.

various transportation services, etc. If we only take a full lump sum of 1,000 KN loss per bed, it's already a minimum amount of 30,000,000.00 KN in the sense of lost profits. It is quite clear that the loss will be far greater, starting with everyone lowering the price to "save what can be saved" (and this will probably be a domino effect) to that the season will start far later beyond doubt (while the situation is as it remains today, many who wanted to choose Split will either not come or would want to pay far less than they would otherwise pay). A very modest calculation shows that (and only if the situation becomes really "normal" from June) the damages in the sense of lost profit will be of at least 100,000,000.00 KN. When damage suffered by at least 200,000 people due to, simply stated, reduced quality of life (non-material damage - the right of personality) is added, then it is damage exceeding 50% of the entire Split budget, and we will agree that it is a threatening disaster that (at least as a subjective effect of one bad year) can easily be switched to the next year. Hope that not everyone will sue is little consolation. Perhaps court costs are not the most significant, but they are certainly not an insignificant question. A lawsuit in which the value of a case of a dispute is about ten thousand kunas refers only to the lawyer's costs of lawsuit, the response to the lawsuit, a couple of hearings, legal remedies and the amount of about ten thousand kunas, to which the cost of the examination (which will surely be valued in thousands kunas) and court fees of at least a few thousand kunas should be added. If we have tens of thousands of litigation, it will be a huge sum in total, which will enrich the lawyers, the judiciary and the state, but at the same time the entire normal court work in Split will be blocked and many of the files will probably need to be redistributed throughout the country. If this happens, the percentages will be higher because the plaintiffs and the defendants will have to travel outside their residence and the damage will only be further multiplied. A special problem lies in many people who cannot afford to run a relatively expensive and absolutely slow court proceeding and who will therefore not start it (which is bad and because it favors those who are notoriously responsible for the damage and who should by all means be punished) or will only run it with poor and unprofessional help, which may be the reason why they will ultimately lose the process. The country, rather than passively observing everything, should achieve that almost everything gets resolved by out-of-court settlements, with prompt and quality assistance to all those seeking help, all as a real proof of the realization of the principle of equality before the law as an important principle of the Croatian law as well as of the European legal acquis. Ultimately, who will pay for all of it, or better yet, who is passively legitimated in the described procedures. Formally, in the foreground there is the municipal utility company and, consequently as well as by nature, its founders (City of Split and other neighboring units of local self-government). However, the Republic of Croatia cannot be released from responsibility, because its bodies formally forced the City of Split and Karepovac to accept garbage from a number of other municipalities and cities<sup>21</sup>, despite the opposition of the utility company and the City of Split. A part of the responsibility lies on the County of Split-Dalmatia, which has been running late with its regional waste center in Lećevica, and the tardiness of which is somewhat the fault of the Republic of Croatia, which in the mandate of one of its deputy ministers, has virtually dropped the project.

#### 4. CONCLUSION

The ideal situation is the one in which the legal framework is created in a timely manner, but without the hastiness which usually means more the mistakes. Unfortunately, in practice, such situations are very rare. In the example at hand in this paper we have come to the conclusion that the legal framework of the Ownership and Other Rights in Rem Act and the Civil Obligations Act contain good solutions. It is significantly worse with regulations that should ensure that every injured party gets the necessary legal protection without problems, even if

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<sup>21</sup> Nineteen units of local self-government together with Split.

they do not have enough financial or other means. That remark also includes a solution to avoid blocking the work of the courts, if tens of thousands of new court proceedings come up. The unpleasant smells from Karepovac are emissions, and this paper analyzed the damage they cause. According to the Ownership and Other Rights in Rem Act, the one who is not the owner of the property has no legitimacy to seek compensation for damage and removal of danger. However, according to the Civil Obligations Act, anyone can demand that another person removes the source of danger which threatens him or anyone else, as well as to refrain from activities which produce disturbance or danger of harm, if disturbance or harm cannot be prevented with appropriate measures. However, there is also a corrective provision according to which, when the damage arises in the performance of the general economic activity for which the approval of the competent body has been obtained (it is not disputed that the Karepovac sanction is carried out on the basis of appropriate permits), only damage compensation exceeding the usual limits (excessive damage) can be demanded. And in this case socially justified measures can be requested to prevent or reduce the damage. We conclude that every inhabitant of Split and Solin who has been exposed to emissions is entitled to seek protection from those emissions from Karepovac and a compensation for damages, be it a proprietary or a legally binding claim.

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## **THE APPLICATION OF THE EUROPEAN PRINCIPLES FOR GOOD ADMINISTRATION IN THE REPUBLIC OF MACEDONIA DE LEGE LATA AND DE LEGE FERENDA**

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### **ABSTRACT**

*It is common knowledge that the organization, the functioning and the modeling of the administrative systems is a national question for every state, which leaves the European Union without a direct influence in the respective area. On the other hand, there is no doubt that by constantly emphasizing the public administration reforms as a key factor for integration, the Union becomes more and more relevant in that respect. Hence, the European institutions and organizations - especially the European Council - play a major role in the establishing of the fundamental European public administration principles. SIGMA is an organization also responsible for control over the fulfillment of the European public administration principles and gives directions on how to achieve these principles. As a part of numerous international acts, declarations and resolutions, these principles' aim is to harmonize the member states' governance systems in light of the way administrative bodies enforce their competences covering also the quality of services and the overall relationship between the authorities and the citizens. This way, certain European standards which, among other things, have a mandatory character are set. All the states striving to join the European Union have to undertake all the measures that will ensure a consistent application of the principles of the European administrative space and the *acquis communautaire*. Consequently, as one of the states claiming to join the Union, the Republic of Macedonia is also obliged to acquire such administrative capacities that will guarantee the application of the *acquis communautaire* - the general Administrative Law principles. This research is therefore focused on the importance of the European principles when speaking about the public administration quality, efficiency, effectiveness, transparency and responsibility. It analyses the legal framework where the European principles are set out, as well as the mechanisms the authorities and bodies undertake in order to ensure better execution of their responsibilities (e.g. electronic communication, enhanced inter-institutional cooperation and communication, training for officials and servants, etc.).*



*Thus, by examining the applicable legislation which regulates the public administration organization and operation we will try to identify and outline the key measures to be taken by the policy makers as to ensure not just de jure but also de facto strengthening of the public sector. In other words, we are referring to the steps necessary to improve the quality of public services and to modernize the administrative procedure, while still achieving depolitization and higher ethical standards. This is in fact the basic objective of the Public Administration Reform Strategy which is based on the progress Reports the European Commission delivers regularly (annually) delivers to the Republic of Macedonia.*

**Keywords:** *acquis communautaire. European integration, public administration, principle of efficiency and effectiveness*

## 1. INTRODUCTION

The public administration has always been an internal matter of the member states of the European Union. However, the member states' public administration is in charge of implementing the directives and recommendations of the European Union, hence its concern to ensure the quality and professionalism of each national administration, that is, the European Union's interest in the administrative capacities of its member states. For this purpose the European Commission has asked SIGMA<sup>1</sup> to assess the alignment of the public administration of the candidate country from Central and Eastern Europe with the principles and standards prevailing among the older EU member states.

The following is required of the candidate countries for EU membership:

- to have administrative systems capable of transposing, implementing and applying the *acquis*, which will achieve defined results.
- to meet the requirements for EU membership adopted by the Council of the European Union, that is, the requirements from Copenhagen and Madrid.
- to measure the progress towards the EU membership in terms of their “administrative and judicial capacities to apply EU regulations - the *acquis*”.<sup>2</sup>

SIGMA, for its part, has the role of evaluating the willingness of the candidate country for membership, assessing certain features of the state administration, such as:<sup>3</sup>

- respecting the principle of legality and the rule of law
- regulations concerning the liability of the officials
- regulations that ensure predictability in decision-making and facilitate judicial supervision of the administrative decisions and actions
- regulations regarding the managing and the control of the public finances and
- total ability of the administrative and judiciary systems for the application of those regulations

Consequently, SIGMA's publications include the five key conditions that need to be met for a successful reform: external pressure, internal dissatisfaction, reform strategy, reform management mechanisms and feedback and evaluation.<sup>4</sup>

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<sup>1</sup> SIGMA is short for the english term of the joint initiative of the EU and OECD that finances the Support for Improvement in Governance and Management of the state administration

<sup>2</sup> Cardona F., *Integrisanje nacionalnih administracija u Evropski administrativni proctor*, 2009, SIGMA, Konferencija o reformi javne uprave i evropskim integracijama, Budva, Crna Gora, 26-27 March, p.2;

<sup>3</sup> Musa A., *Evropski upravni proctor: približavanje nacionalnih uprava*, 2006, Javna uprava- nastavni materijali, Pravni fakultet u Zagrebu, Zagreb, p.404

<sup>4</sup> SIGMA radovi: no.26, Poglavlje 2: Les Metkalf, U susret izazovu pristupanja, p.51

The criteria for EU membership, as defined by the Council of the European Union, are:<sup>5</sup>

1. Copenhagen 1993: stability of the institutions that guarantee democracy, rule of law and human rights;
2. Madrid 1995: adjustment of administrative and judicial structures so that the EU law can be transposed and effectively implemented;
3. Luxembourg 1997: strengthening and promotion of the institutions or strengthening of the operational capacity of the institutions
4. Helsinki 1999: the obligation of the candidate country to share EU values and goals as defined in the Treaty

"The Copenhagen and Madrid criteria in fact demand a professional state administration, free from inadequate politicization, based on merits, which works in accordance with acceptable standards of integrity. They demand a clear division between politics and the administration."<sup>6</sup> And this can be achieved through the impartiality, responsibility and integrity of administrative officials. At the same time, the European Commission does not propose a specific model of organization and functioning of the state administration, but the Commission insists that the countries adopt a law that applies specifically to the civil service; advocates for a career system in the civil service; independence of the state administration from political authority; importance of trainings; a raise of the salary of the state sector to that of the private sector.<sup>7</sup> All these principles or standards, common to the EU member states, that refer to the work of the public administration compose the so called European administrative space, which means that the EAP includes a set of common standards for action within the public administration that are defined by law and applied in practice through procedures and liability mechanisms.<sup>8</sup> First of all, it is based on four basic principles - the rule of law, confidentiality and predictability, the principle of openness and transparency, the principle of responsibility and the principles of efficiency and effectiveness.<sup>9</sup> In fact, we can classify the European principles in three groups: those relating to administrative officials (professionalism, impartiality, loyalty, prevention of conflict of interest, discretion), public service providers and services (independence, accountability, consistency, availability, efficiency, effectiveness) and quality of regulations (simplicity and clarity).<sup>10</sup> In relation to the office system, development of individual civil servant's responsibility, sufficient security in terms of employment, stability and level of earnings, as well as clearly defined rights and obligations are necessary, and the employment and promotion are merit-based.<sup>11</sup> Therefore, it is considered that "a modern, constitutional state service in democracy is possible only if the following conditions are met: separation of the public from the private sphere and separation of the politics from the administration - although they are interdependent, they still have a different source of legitimacy. The politics is based on public trust expressed through free political elections and is determined after each political mandate.

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<sup>5</sup> Cardona F., *Integriranje nacionalnih administracija u Evropski administrativni proctor*, SIGMA, Konferencija o reformi javne uprave i evropskim integracijama, Budva, Crna Gora, 26-27 March, 2009, p.5

<sup>6</sup> Ibid., p.6;

<sup>7</sup> III del: Pripreme za ulazak u Evropski administrativni proctor, Poglavlje 7: Žak Furnije, *Administrativna reforma prema misljenjima Komisije o pristupanju zemalja srednje i istočne Evrope Evropskoj uniji*, p.106;

<sup>8</sup> Г.Силјановска-Давкова, Т.Трендафилова, Р.Тренеска, *Прирачник за полагање преоден испит*, Скопје, 2001, p.188;

<sup>9</sup> European Principles for Public Administration, OECD-Sigma, paper no.27

<sup>10</sup> Simac N., *Evropski upravni proctor i europska nacela javne uprave*, Zbornik radova pravnog fakulteta u Splitu, god. 49, 2/2012, p. 351.-368, taken from file:///C:/Users/User/Downloads/zb201202\_351.pdf

<sup>11</sup> Taken from Raadsheiders and Rutgers, "The Evolution of Civil Service Systems", in Bekke, Perry and Toonen (editors), *Civil Service Systems in Comparative Perspective*, Indiana University Press, 1996, SIGMA radovi: no.27 Evropski principi za drzavnu upravu, p.219

The administration is based on merits, and the professional ability of civil servants is entrusted to public contests for entry in the civil service, in accordance with the conditions prescribed by law".<sup>12</sup> The principles of openness, participativeness, responsibility and effectiveness are in fact the principles of good administration. Good administration involves the development of the best practices and standards in the dealings.<sup>13</sup>

## 2. EUROPEAN PRINCIPLES OF GOOD ADMINISTRATION IN THE REPUBLIC OF MACEDONIA

The Republic of Macedonia, as a transition country for more than two decades, faces the challenges of the new social order, which according to the Constitution of the Republic of Macedonia is based on the principles of separation of powers, the market economy and the introduction of pluralism (multiparty system). Since its independence, the Republic of Macedonia is committed to joining the EU and undertakes a number of measures to meet the criteria required for EU as well as NATO integration. However, during the process of implementation of the reforms, we faced numerous obstacles and problems that are constantly reflected in the reports that the EU Enlargement Commission submits to the Republic of Macedonia, which reflects on the non-opening of EU accession negotiations. The unsettled bilateral issue between the Republic of Macedonia and the Republic of Greece, concerning the name, is particularly influential here. The historical development of the Republic of Macedonia's entry into the EU has been marked by several periods, such as: the signing of the Stabilization and Association Agreement of 2004, when the EU integration process began intensively, the acquisition of the candidate status in 2005 and the visa liberalization process. From the acts drafted by the Republic of Macedonia, aimed at reforms in the public administration, we highlight the following: the Public Administration Reform Strategy of 1999, the Public Administration Reform Strategy for the Period between 2010 and 2015, the National Strategy for Integration of the Republic of Macedonia in the European Union since 2004, the National Program for the Adoption of the Acquis of the European Union (2014-2016), the Strategy for Public Administration Reform 2018-2022<sup>14</sup>. According to the National Strategy for Public Administration Reform in the Republic of Macedonia, the main goals of the reform are the following: compliance and training of the public administration in the Republic of Macedonia for a continuous process of transposition and implementation of the European legislation; empowering the public administration to create and implement the overall reforms of the economic, political and legal system and building institutions necessary for securing the free flow of goods, capital, services and people in the EU.<sup>15</sup> The basic vision is to achieve a depoliticized, efficient, effective and accountable public administration that provides quality and easily accessible services for the citizens and the business community on the whole territory of the Republic of Macedonia. In addition, the work of the public administration is based on European principles and values and contributes to sustainable economic growth, the rule of law, social cohesion and well-being.<sup>16</sup> Special accent is put on continuing the coordination of the public administration reform process, providing and developing a professional, professional, efficient, responsible, transparent and service oriented state and public service, improving the quality of administration according to the ISO 9001 standard and implementing generic and specialized training of state and public officials.

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<sup>12</sup> SIGMA radovi: no.27 Evropski principi za drzavnu upravu, p.220

<sup>13</sup> Lozina D., Klarić M.: *"Dobra uprava" kao upravna doktrina u Evropskoj uniji*, PRAVNI VJESNIK GOD. 28 NO. 2, 2012, file:///C:/Users/User/Downloads/lozina\_klaric%20(3).pdf

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<sup>15</sup> Национална стратегија за интеграција на Република Македонија во Европската унија, Влада на РМ, Скопје, 2004, p.16

<sup>16</sup> [http://www.mio.gov.mk/files/pdf/dokumenti/SRJA\\_2018-2022\\_20022018\\_mk.pdf](http://www.mio.gov.mk/files/pdf/dokumenti/SRJA_2018-2022_20022018_mk.pdf)

A special attention should be paid to the coordinating of the assistance from the European Union and the Member States, as well as to the coordinating of the other foreign assistance, including the capacity building, in order to provide support for the reforms that are complementary to the process of integration of the Republic of Macedonia in the EU.<sup>17</sup> If we want to talk about the compliance of the legislation in the Republic of Macedonia with the European principles, we must outline the basic public administration principles listed in the 2017 SIGMA publication. SIGMA classifies the European principles for public administration reform in six areas:<sup>18</sup>

1. the strategic framework of the public administration reform
2. policy development and coordination
3. public service and human resources management
4. responsibility
5. service delivery and
6. public financial management

Within all these areas are listed the basic principles that should be respected for the purpose of consistent implementation of the set goals and tasks. Thus, within the framework of the first area, the basic principle is the preparation of a strategy for public administration reform that will outline the key challenges and the establishment of a separate central government body, and also it is necessary to list the basic goals and the expected results, as well as the method of monitoring the planned. The third principle is the financial sustainability of public administration reform and the last principle is the coordination between the political and administrative level in the implementation process. According to the framework of the second area, the basic principles are: - fulfillment of all functions that are crucial for a well-organized, consistent and competent policy-making system by the central government institutions, the establishment of clear horizontal procedures for regulating the national European integration, and the process need to be established and implemented under the coordination of the responsible body; to establish a harmonized medium-term plan for planning, with clear government objectives; regular monitoring of the government's work; to make transparent government decisions based on a professional evaluation of the administration and to ensure legal compliance of the decisions; the parliament controls the creation of government policies, while the organizational structure, procedures and personnel allocation in the ministries should ensure the establishment of the developed policies and legislation according to the government objectives; European integration procedures and institutional set-ups form an integral part of the policy-making process that needs to ensure systematic and timely transposition of the European Union acquis, policies and legislation should be designed in an inclusive way that enables active participation of society and enables the coordination of different perspectives inside the Government; legislation is consistent in structure, style and language; and is applied consistently in all ministries. The following principles are incorporated in the third area: the scope of the public service should be appropriate, clearly defined and applicable in practice; as should be the policy and legal framework for a professional and coherent public service; the institutional setup should provide consistent and effective human resources management practices in the public service; the recruitment of administrative officials should be based on merit; there should be no direct or indirect political influence on senior managerial positions in the public service; the remuneration system of civil servants should be based on the classification of jobs and the remuneration procedure should be conducted in a fair and transparent manner; professional development of administrative officials should be ensured,

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<sup>17</sup> Национална програма за усвојување на правото на Европската унија, ревизија 2014 - 2016 December, 2013, <http://www.sobranie.mk/WBStorage/Files/00npaa2014narativenobjavuvanje.pdf>

<sup>18</sup> [www.sigmaxweb.org/Principles-of-Public-Administration\\_Edition-2017\\_ENG%20\(1\).pdf](http://www.sigmaxweb.org/Principles-of-Public-Administration_Edition-2017_ENG%20(1).pdf)

which implies the maintenance of regular training of administrative officials and undertaking measures to promote integrity, prevent corruption and providing discipline in public services. In the fourth area that relates to responsibility the following basic principles are emphasized: the existence of internal, political, judicial and social responsibility; the right to access public information should be provided by law and consistently applied in practice, to have functioning mechanisms for protection of the rights of the individual to good governance and protection of the public interest; judicial protection in administrative disputes should be ensured; public authorities should take responsibility in cases of misdemeanors and guarantee compensation and / or adequate compensation. In the fifth area, the main task is the delivery of services, and the public administration is required to be citizen-oriented; the quality and availability in providing public services. For an adequate implementation the following principles are stated: the existence of a legal framework that guarantees that the civil service is citizen-oriented and applied in practice; establishment of mechanisms for ensuring the quality of the public service, ensuring the availability of public services. The sixth area is dedicated to public financial management and the following principles are stated: a medium-term budget framework covering a minimum period of three years should be prepared; the Ministry of Finance (or an authorized central body) should control the payment of funds from the sole account of the treasury bank and provide liquidity; also, the existence of a clear debt management strategy; established operational framework for internal control in which the responsibilities and authorizations are defined, and its application by the budget organizations; the existence of an operational internal audit framework that reflects the international standards and its application by the budget; public procurement regulations (including public-private partnerships and concessions) that should be aligned with the *acquis* of the European Union; the legal remedies system should be harmonized with the *acquis* standards of the European Union which ensures independence, honesty and transparency and prompt and competent handling of complaints and sanctions; public procurement is carried out in accordance with the basic principles of equal treatment, non-discrimination, proportionality and transparency, while ensuring the most efficient use of the public funds; the existence of an independent audit institution that provides high quality audits that positively affect the functioning of the public sector. What can be concluded is that in relation to the fulfillment of these principles, *de lege lata* in the Republic of Macedonia a number of new legal solutions have been adopted, amendments to the existing ones have been made in order to incorporate the principles required by the European Union. As an example, Law on General Administrative Procedure, the Law on Electronic Governance, the Law on Introduction of a Quality Management System and the Common Framework for Assessing the Work and Providing Services in the Civil Service, the Law on Free Access to Public Information, The Law on the Use of Public Sector Data, the Law on Prevention of Corruption, the Law on Prevention of Conflict of Interest, the Law on Administrative Officers (civil servants), the Law on Public Sector Employees and others regulations. What is missing is their consistent implementation, which is also indicated in the Annual Reports submitted to the Republic of Macedonia by the European Commission. This points to the fact that *de lege ferenda* in practice certain inconsistencies appear, for which, in the future appropriate measures and mechanisms must be taken in order to enable the *de facto* implementation of what is legally established, and the results to be visible for both the institutions and for the citizens. As an example, we would point out several legal solutions. Regarding the first area that concerns the preparation of a strategic framework, we would point out that the Republic of Macedonia constantly prepares multiannual strategies for the public administration reform in which the key priorities of the reforms are outlined. For example, in the 2010 Strategy, the focus has been put on some of the most important multidisciplinary functions of the administration, or the so-called contemporary administration functions, consisted of: a) policy making, b) inter-institutional cooperation and coordination, c) human resources development and management, d) public

finances, including public procurement, e) anti-corruption measures f) optimization and simplification of business processes, e) improvement and simplification of administrative procedures and administrative services, h) provision of access to public information and i) e-government and e-governance. The above-mentioned modern management functions are important for the entire public sector, regardless of the organizational form and administrative level (central, regional, local). This will be the scope of the "public administration reform" in the Republic of Macedonia. Hence, the reform will cover the entire public sector.<sup>19</sup> At the moment, an adoption of the Public Administration Reform Strategy for the period 2018-2022<sup>20</sup> is expected, in which the mechanisms for coordination of the process of planning and policy making, as well as the drafting of laws are established through the competences of the following main institutions: the General Secretariat of the Government of the Republic of Macedonia, the Ministry of Finance, the Ministry of Information Society and Administration, the Secretariat for European Affairs and the Secretariat of Legislation. The reforms in the field of the official (civil servants) system in the Republic of Macedonia started with the adoption of the Law on Civil Servants, which was enacted in 2000. With this law for the first time since the independence of the Republic of Macedonia there was a separate law which made the distinction between the employees in the private sector, and the employees in the state administration whose rights, obligations and responsibilities are now regulated by the Law on Civil Servants. However, the fact that public servants were not covered by this law pointed the need for an adoption of another law - the Law on Public Officials, adopted in 2010, whose purpose was to regulate the rights and obligations of the employees in the public services. This law, however, did not really apply in practice because to the employees in the field of health lex specialis laws such as the Law on Secondary Education, the Law on Higher Education were applied, and to the employees in the field of education, the lex specialis Law on Health Care was applied etc. All of this indicated that the reforms in this area should continue and in order to overcome the existing situation concrete measures were taken. Hence, the reforms in the civil service system continue in 2014 with the adoption of two new legal solutions: the Law on Public Sector Employees and the Law on Administrative Officers, which had a suspensive effect on the application of February 2015. The purpose of these legal solutions was to establish a uniform system for employment, promotion, evaluation, responsibility of all administrative officials, but also to create criteria for equalization of salaries for the public sector employees. The main novelties that were envisaged are the preparation of a special catalog of jobs, employment plans<sup>21</sup>, ways of recruiting staff, assessment and increased responsibility. The catalog includes a description of the jobs together with their functional names for each job. There were numerous indications for this by eminent professors from the administrative department, who consider this to be one of the ways to solve the problem of temporary employment of administrative officials, which reaches a figure of 30% to 40% of the total number of employees in the public sector. The issue of passing a law which would determine the criteria for salaries of the administrative officials is still open. In terms of training, it is necessary to establish a special training center - an institution that would have similar status and competencies such as the existing Academy for Judges and Public Prosecutors. One of the positive novelties is that with the Law on Public Sector Employees, for the first time a legal authority of a state body was established, in order to establish and maintain a single registry of

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<sup>19</sup> Стратегија за реформа на јавната администрација во Република Македонија (2010-2015 ГОДИНА), 21 December 2010, [http://mioa.gov.mk/files/pdf/dokumenti/Strategija\\_zarJA.pdf](http://mioa.gov.mk/files/pdf/dokumenti/Strategija_zarJA.pdf)

<sup>20</sup> [http://www.mio.gov.mk/files/pdf/dokumenti/SRJA\\_2018-2022\\_20022018\\_mk.pdf](http://www.mio.gov.mk/files/pdf/dokumenti/SRJA_2018-2022_20022018_mk.pdf)

<sup>21</sup> The professors from the administrative department continually pointed out the necessity of this novelty in their scientific papers, see also: Давитковски Б., Павловска-Данева А., Муцунски Т., *Јавната администрација на РМ - носител на процесот на евроинтеграција*, Зборник на Правниот факултет „Јустинијан Први“ во Скопје, во чест на проф.д-р Наум Гризо, Скопје, 2011

all employees in the public sector institutions. In accordance with Article 19 paragraph 1 of this Law, the Ministry of Information Society and Administration, as a state administrative body responsible for administrative reform, was obliged to establish and maintain a register of public sector employees in electronic form. Pursuant to Article 2 paragraph 1 of the Law on Public Sector Employees, the Register includes persons employed in: the state and local government bodies and other state bodies established in accordance with the Constitution and law; and the institutions that perform activities in the fields of education, science, health, culture, labor, social protection and child protection, sports, as well as in other activities of public interest determined by law, organized as agencies, funds, public institutions and public enterprises established by the Republic of Macedonia or the municipalities, the City of Skopje, as well as the municipalities in the City of Skopje. This report on the data from the Register of Public Sector Employees for 2015 is prepared on the basis of Article 20 paragraph 1 of the Law, and is the first report of this nature, in which the data on the public sector institutions are systematically presented in relation to their number, type, title, branch of government, activity and founder, as well as data on the employees in these institutions about their number, groups, subgroups, levels, titles, gender positions, age, level of education and community affiliation. According to the data provided in this report out of the total number of 1288 institutions in the public sector, the total number of employees is 128 347 persons. Out of these, 40 196 are employed in state organs, 11 325 in the Ministry of Internal Affairs, 7205 in the Army of the Republic of Macedonia, 227 in the Intelligence Agency, 2858 in the judiciary and 18 581 in other state authorities. In the City of Skopje and the municipalities, there are 5744 employees in total, and 64 168 in the public institutions, where 19 855 are employed in the public institutions in the field of health, 3282 are employed in the public institutions in the field of culture, 34 338 are employed in the field of education, and in the public institutions in the field of labor and social affairs. The remaining 18 239 are employed in public enterprises. This number does not include the elected and appointed persons who, according to the definition of Article 2 of the Law on Public Sector Employees, do not belong to the employees in the public sector.<sup>22</sup> The second such Report for 2016 provides the following data. There are 129,653 persons in the public administration enrolled in the register of employees in the public sector in 1,291 institutions. According to prof. Davitkovski, compared to the previous report, it is obvious that the number of employees in the Army, and in education and health care is growing, in comparison with the classical civil servants in the ministries, whose number unfortunately decreases, and if the total figure is taken into account and the state administration is compared with the rest of the employees in the public sector and the employees in the private sector, it can be noticed that according to European and world standards the public administration is overloaded, while there are too little employees in the state administration. Therefore, it is necessary for this trend to be well noted and investigated. At the same time, another trend are the employments according to the Ohrid Framework Agreement which have grown from 10 percent to 19.4 percent, that is, about 20 percent, as well as the aging of our administration.<sup>23</sup> According to the data from the Register, we have too many public sector employees, which need to be reduced, especially in the area of public services. In order to do this, it is necessary to make a detailed analysis of which part or what kind of employees is a surplus and to find ways and mechanisms to reduce this overcapacity. For example, if we examine healthcare, we need to analyze the number of employees in the administration, nurses, paramedics, physicians, to determine the necessary number of the people on which the continuous performance of the

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<sup>22</sup> Годишен извештај за податоците од на вработените во јавниот сектор за 2015 година, [http://mioa.gov.mk/files/pdf/dokumenti/Registar\\_mart2016.pdf](http://mioa.gov.mk/files/pdf/dokumenti/Registar_mart2016.pdf)

<sup>23</sup> Годишен извештај за вработени во јавниот сектор, (Annual report on the data from the register of employees in the public sector ), <http://vesti.mk/read/news/12374634/4306563/vo-javniot-sektor-vraboteni-vkupno-129-653-lica>

tasks would depend, and then take appropriate measures for the others. Regarding the institutional setup or the organizational structure of the public administration, we would point out that in the Republic of Macedonia, despite the fact that the decentralization process began from 1 July 2005, the number of central bodies is still alarming and points to the need of a detailed functional analysis that will serve to reorganize and optimize the number of institutions. For example, considering the data obtained from the Register of Public Sector Employees, the total number of institutions in the Republic of Macedonia is 1288. Out of those, public institutions are 888, public enterprises 128, municipalities 81, courts 35, independent state administration bodies 32, composition of ministries 29, Public Prosecutor's offices 29, legal entities with public authorizations 16, Ministries 15, independent state bodies 12, regulatory bodies 10, Secretariat in Government 3, Judicial Council 2, Government of the Republic of Macedonia 1, President of the Republic of Macedonia 1, Ombudsman 1, National Bank 1, a special state administration body 1, Government service 1, Hall 1, Council of Public Prosecutors 3. There are 763 or 59% local institutions, and 525 or 41% institutions at the central level. The largest number of institutions are in the field of education, a total of 538, representing 41.67% of the total number of institutions in the public sector.<sup>24</sup> Regarding the service delivery area, we would point out the new Law on General Administrative Procedure, adopted in July 2015, in which the emphasis is on the service orientation of the public administration and efficient, effective and quality administrative and procedural protection is guaranteed. Regarding the incorporated European principles in this law, we would state the principle of proportionality, the principle of delegation of competence, evaluation of evidence, electronic communication between the parties in the procedure, the wider subject of application of the law, which is now applied not only for the adoption of specific administrative acts, but also for the provision of public services, undertaking of material actions and concluding of administrative contracts. The ambivalent nature of the administrative procedure comes to light through the principle of proportionality, which used to be a principle of protecting the rights of citizens and protecting the public interest, and which in fact, is one of the principles of the good governance model. The principle of hearing the parties, which on the one hand allows the party to actively participate in the procedure, and on the other hand affects the transparency of the procedure, providing legal security for the party and respecting the principle of legality. This principle is also indicated in the Resolution and the Good Governance Recommendation. The principle of equality, impartiality and objectivity affects the exercise or the alignment with Article 6 of the European Convention for the Protection of Human Rights, which the independence and impartiality of the body when deciding in the procedure is required. Regarding the area of responsibility and accountability, several laws have been adopted, such as the Law on Free Access to Public Information, the Law on Prevention of Corruption, etc., in which the European principles were incorporated. However, despite the efforts and the numerous institutional reforms, the remarks from the Progress reports on the Republic of Macedonia prepared by the European Commission say that the Republic of Macedonia is not yet fully prepared for the consistent application of the principles and points out that in the future a strong political will to ensure the independence of the administration and respect for the principles of transparency, merit and equitable representation is much needed. Particularly concerning are the European Union's remarks in the Progress Report of 2015 according to which: "The country is moderately prepared in terms of the reform of its public administration. Some progress has been made in the legislation and improvement of the provision of services to citizens and business entities. The concerns about politicization have increased with the content of leaked conversations and delaying the full implementation of the new legal framework".

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<sup>24</sup> Годишен извештај за податоците од регистарот на вработени во јавниот сектор 2016 (Annual report on the data from the register of employees in the public sector)



The specific remarks are that "the country should in particular: deal with the serious concerns about the politicization of the public service; ensure full implementation of the principles of accountability, transparency and merit (Emergency reform priority, including the introduction of an enhanced information system for human resource management); suspend and re-examine the implementation of the Law on Transformation in full-time employment until the principle of merit is fully respected (Emergency reform priority); adopt a Public Administration Reform Strategy and a Public Finance Management Reform Program that will address identified weaknesses, including budgetary transparency. What is also indicated is the increased number of targeted, as well as political and arbitrary employments. The concerns also apply to the transparency of the staff mobility and possible abuse of the dismissal procedures. The public sector is additionally inflated with the practice of creating new jobs on a political or social basis, especially before the new laws enter into force. The efforts to achieve the goals of equitable representation do not always take into account the real personnel needs of the institutions and the principle of merit, while the number of public sector employees that do not have to appear at work is increasing. Budget transparency is not provided because comprehensive, timely and credible budget information is not publicly available. In addition, the fiscal strategy 2015-2017 and the 2015 budget were adopted without proper parliamentary discussion."<sup>25</sup> The 2016 report suggests that there is not enough commitment to implementing the Commission's recommendations since 2015. The main remarks are that the public sector is used as a political instrument and politicization in the administration. Likewise, the lack of political commitment to deliver the necessary reforms in the management of public finances has led to a significant reduction in EU financial assistance in 2016. It is also necessary to reduce the excessive classification of documents by the government as confidential (also "Emergency reform priority"), which hinders the citizens' right to access to public information, the existing complaint procedure remains difficult, complex and long, and consists of several degrees, while the interoperable framework is not functional due to lack of resources and political will to implement.<sup>26</sup> What the European Union points out to us is that the future reforms should ensure the professionalisation of the heads of the administrative agencies and bodies, the MISA should have adequate resources to fulfill its responsibilities for professional training and development of the administrative officials and should develop all necessary tools to meet the requirements of the new legislation. The government should review the service modernization setting, including digitalisation of public services, in order to match the strategic goals with the available resources. The MISA should review the existing inventory of government information systems, databases and registers, and respond to how they can be streamlined, their quality increased, and registers integrated into the common interoperability framework.<sup>27</sup> In order to achieve the stated goals and improve the reforms in the new PAR Strategy 2018-2022, the formation of a Public Administration Reform Council is intended, which together with the other

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<sup>25</sup> The Law on Transformation into Full-time Employment was adopted in February in a shortened procedure and without prior consultation with the public on a national level and the EU partners, only a few days before the Ohrid Framework Agreement laws entered into force. This law bypasses the principles of employment based on merits by converting thousands of temporary employed into full-time public service employees or public sector employees without a public competition. While the employment of representatives of the largest non-majority community is growing, the smaller communities remain less represented.

Извештај за напредок на Република Македонија за 2015, taken from [http://www.sobranie.mk/content/%D0%9D%D0%A1%D0%95%D0%98/PR2015\\_All\\_CK\\_FF\\_MK\\_16.11.2015.pdf](http://www.sobranie.mk/content/%D0%9D%D0%A1%D0%95%D0%98/PR2015_All_CK_FF_MK_16.11.2015.pdf)

<sup>26</sup> [https://eeas.europa.eu/sites/eeas/files/20161109\\_report\\_the\\_former\\_yugoslav\\_republic\\_of\\_macedonia\\_mk.pdf](https://eeas.europa.eu/sites/eeas/files/20161109_report_the_former_yugoslav_republic_of_macedonia_mk.pdf)

<sup>27</sup> <http://www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf>, <http://www.sigmaweb.org/publications/principles-public-administration.htm>

competent institutions will take care of the coordination and the undertaking of appropriate measures in the process of implementation of the set goals and tasks.<sup>28</sup>

### 3. CONCLUSION

The purpose of this research was to determine the level of readiness of the public administration in the Republic of Macedonia for accepting the European standards in building capacities and the work of the public administration bodies. In concurrence with the foregoing, we can conclude that every country, even the Republic of Macedonia, which pretends to enter the European family, has to fulfill these principles in a way that will bring an appropriate legal framework in which they will be guaranteed, but also to ensure political climate and stable institutions that can ensure consistent application of the foreseen principles. Therefore, we believe that the Euro-integration process requires serious commitment from the Republic of Macedonia and the undertaking of adequate normative and institutional reforms, prepared and based on previous analyzes and strategies for the measures that need to be taken. What is required of the Republic of Macedonia is the fulfillment of the Copenhagen criteria and the principles of good governance, the concrete introduction of a career system in recruiting administrative officials in the public administration bodies, responsible, efficient and transparent public administration, affirmation and strengthening of the role of the non-governmental sector or civil society in creating public policies, providing administrative capacity for effective programming and management of IPA funds. The measures that need to be taken consist of the preparation of Action Plans and Programs, the establishment of a separate body, that is the Training Center for Administrative Officers, conducting an annual evaluation and monitoring over the implementation of the specific steps foreseen in the action plans and programs, preparation of reports on what is implemented and what is not and what are the obstacles faced by the institutions in the implementation of the reforms and the high political will for achieving the predetermined goals. In the very near future, concrete measures should be undertaken in order to establish clear criteria for the establishment of new bodies, reorganization the public administration, improvement of the communication between the institutions and the citizens, professionalization and de-politicization of administrative officials, the digitization in the institutions will be done, the institutions' accountability will be increased, especially when providing information of public character, higher quality of services will be ensured, increased responsibility and accountability of the employees and the institutions especially in the use of public funding, establishment of a consistent system of salaries, and in each of the institutions it is necessary to implement a quality management system. Only this way can we restore the confidence in the institutions, reduce the politicization of the administration (reduce the influence of the political officials on the personnel policy) and enable the realization of the principle of the rule of law.

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<sup>28</sup> [http://www.mio.gov.mk/files/pdf/dokumenti/SRJA\\_2018-2022\\_20022018\\_mk.pdf](http://www.mio.gov.mk/files/pdf/dokumenti/SRJA_2018-2022_20022018_mk.pdf)

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## **SAFETY AND LEGAL FRAMEWORK ON PREVENTING OF USE OF THE FINANCIAL SYSTEM FOR MONEY LAUNDERING ACCORDING TO SOLUTIONS OF DIRECTIVE (EU) 2015/849**

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### **ABSTRACT**

*Directive (EU) 2015/849 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing replaces Regulation (EU) 648/2012 and exempts Directive 2005/60 / EC and 2006/70 / EC and upholds the legislative basis for preventing the use of the financial system for the purpose of money laundering or terrorist financing. The fact is that illegal cash flows may endanger the stability of the financial system as a whole or a specific sector of that system. This can undermine the stability of the European Union's internal market. For this reason, Directive (EU) 2015/849, the fourth dealing with money laundering, has guidelines to protect society against criminal activities such as money laundering and the protection of the stability of the European Union market as well as the markets of each of its members separately. An important part in this process is the national risk assessment of money laundering and terrorist financing that has the purpose of identifying Member States money laundering risks and setting specific targets in the fight against these same threats. In order to do so, it is important to have quality information in a timely manner, statistically based and complemented by intelligence agencies, expert opinions and clear data from the private and public sector. In order to facilitate Member States transitional period for the implementation of the Directive (EU) 2015/849 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing, the Financial Action Task Force on money laundering and terrorist financing (FATF) establishes certain standards and recommendations for easier implementation of the Directive. Accordingly, it is important to distinguish key concepts such as risk, threat, vulnerability, and consequence, so that the money laundering risk assessment itself could be applied in further steps to mitigate and prevent such risks.*

**Keywords:** *financial system, legal framework, money laundering, national risk assessment, security*

### **1. INTRODUCTION**

Placing illegally acquired money into legal flows can seriously undermine the stability of the financial system, especially if it is not isolated cases, but the constant presence of illegal activities of this kind. Accordingly, Directive (EU) 2015/849 was adopted, which is the fourth directive dealing with the threat of money laundering and terrorism financing. These activities are presented and implemented in an international environment, and measures taken only at the level of one state or even throughout the European Union would not have a significant impact on the fight against money laundering and the financing of terrorism.

For this reason, international co-ordination and co-operation in the strategic issue are necessary at the global level to enhance the effectiveness of legal acts in the fight against money laundering. The measures in this Directive deal with the manipulation of money drawing on serious criminal offenses and the Financial Action Task Force recommends a package of measures that should be applied to the legislative framework. Directive (EU) 2015/849 was adopted by the European Parliament and Council on 20 May 2015 and entered into force in the Republic of Croatia on 1 January 2018. Additionally, it is important to emphasize that each EU member state compiles its national risk assessments of money laundering and terrorism financing where the Financial Action Task Force guidelines are also used to identify risks, threats, vulnerabilities and possible consequences. The assessment of the risk of money laundering and terrorism financing is a procedure based on the action of pre-arranged forms of parties involved and the risk assessment alone is used as a first step in solving the risk problem. Each country sets itself acceptable and specific risk assessment objectives such as raising financial resources to official bodies that deal with these types of situations, and the quality of risk assessment depends largely on available information and their quality. The methodology of the national risk assessment of money laundering and terrorism financing in the Republic of Croatia has been conducted in accordance with international standards with emphasis on the effective use of all available human and financial resources in the prevention of money laundering and terrorism financing, as well as the prevention of the use of financial and other sectors for this purpose and efficiently and the rapid detection of perpetrators of money laundering or terrorist financing (National Risk Assessment of Money Laundering and Financing of Terrorism in the Republic of Croatia, 2016, p. 9). Such a methodology consists of 7 steps, namely: identification of threats conducted by the State Attorney's Office of the Republic of Croatia, national vulnerability followed by the Office for the Prevention of Money Laundering, the vulnerability of the banking sector under the jurisdiction of the Croatian National Bank, the vulnerability of the loan stock and Securities Sector conducted by the Croatian Financial Services Supervisory Agency and other financial and non-financial institutions run by the Financial Inspectorate.

## **2. MONEY LAUNDERING - METHODS AND PHASES**

Money laundering is a process where many techniques and methods are used to bring the inflow of money from one source into another (Schroeder, 2001, p. 1). Money laundering has potentially quite large and serious economic, social and security implications (McDowell, Novis, 2001, p. 1). Each money laundering process consists of at least three phases (Katušić-Jergović, 2007, p. 621-623):

1. The phase of hiding money
2. Money Transfer Phase
3. The phase of money investment

The first phase is also the most important for detecting illegal money. The funds are invested in financial systems through various small transactions where they are used as a means of payment in acquiring things of different market values. Many ways and means of executing such transactions have been: currency shuffling, bank participation, currency exchange, business start-ups, real-estate purchases. In the second phase, it is becoming increasingly difficult to find a source of dirty money and illegal activities. At this point, the usual methods of converting cash into banking monetary instruments, i.e. bank drafts and cash orders, and assets that were bought in cash and then sold to any physical or legal person. The third stage is the phase of dirty money investment, where the money that is already being depleted is filtered through financial systems, mostly through banks, and is presented as a normal income of a normal business. Money is invested in legal flows in several ways.

Most often, however, they are dealing with real estate trading, but there are also different methods of falsifying money from newly-opened companies, then by the participation of foreign banks in this process and false import/export invoices that are a very efficient way of integrating illegal money. Such false invoices most often contain an inflated value of goods and services that are used to justify cash deposits in domestic banks. It is not necessary to follow every step and stage of money laundering, it may depend on the variety of situations. The problem is often that banks, as the largest recipients of cash resources, know how to engage in money laundering and consciously with a certain commission on large sums of cash, which ultimately results in a criminal offense of corruption, apart from money laundering. When dealing with money laundering, it is characteristic that more people are involved because of the volume of work that needs to be coordinated and the long duration of the whole process and the "no national boundaries" effect. Of course, the question that first of all comes to mind is for what purpose is money to be laundered?! Except for the realization of personal illegal use, money laundering may have the purpose of financing terrorism or drug trafficking. Any of these two illegal activities uses "underground" banking networks to make cash transfers proliferate little or no paper trace. Such systems initially operated most through Asia or the Middle East and mostly have codenames "hawala" or "hundi" (Milošević, 2016, p. 558), but now they have passed the whole world and pose a big problem. Since such illegal systems cannot simply be controlled by laws or prevention actions, they represent a huge base for illegal activities in terms of terrorism financing, drug trafficking where so-called "Dealers" who transport and process transactions are considered key people in these systems. It is necessary to break such terrorism financing channels as a key item in the fight against it (Dinić, 2016, p. 968). The word "hawala" comes from Arabic history and translates a trust or transfer that in itself speaks of the continuance of such a kind of money laundering and terrorism financing, and is considered to have been used for the first time in such a system in the first half of the 20th century. This is just one of the reasons why money laundering is a global problem and what impact it may have on the economic situation in world markets, the safety of people around the world, and ignorance of how to fight and defend against terrorist attacks that violate all the rules of international law (Glavina, Simić Banović, 2017, p. 47).

### **3. THE LEGAL FRAMEWORK OF THE DIRECTIVE**

Directive (EU) 2015/849 was adopted by the European Parliament and the Council on 20 May 2015 and addresses the prevention of the use of the financial system for the purpose of money laundering or terrorism financing (hereinafter: the Directive). At the same time, Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and Directive 2005/60 / EC of the European Parliament and of the Council and Directive 2006/70 / EC has been repealed. In order to prevent the use of the financial system for money laundering or the financing of terrorism, it is necessary to define what is considered as money laundering and terrorism financing. In this Directive, money laundering, if carried out intentionally, is considered to be:

1. Conversion or transfer of property obtained by criminal activity or deliberate participation in such activities, all for the purpose of concealing or evading the origin of such property or assisting a person involved in such activities.
2. Knowingly evading or concealing property ownership.
3. Possession, use and acquisition of property that is known to have been acquired by or engaged in a particular criminal activity at that time.
4. Assistance, encouragement, attempt to implement, an association for the purpose of implementation or participation in any of the activities referred to in items 1, 2 and 3.

The term terrorism financing represents, at least as far as this Directive is concerned, any securing or collecting of funds, with the knowledge and awareness that it is used or intended

for use in the criminal offenses described in Article. 1. - 4. Council Framework Decision 2002/475 / PUP of 13 June 2002 on combating terrorism. In order to make the Directive as effective as possible and implemented in the legislation of the Member States of the European Union ("EU Member States") in Art. 2 of the Directive clearly sets out which of the tributary it applies, namely:

1. Credit institutions,
2. Financial institutions,
3. Natural or legal persons in carrying out their professional activities as:
  - a) Auditors, Accountants and Tax Advisors,
  - b) Notaries
  - c) Fiduciary service providers and companies not belonging to a group of credit or financial institutions
  - d) Agent or Real Estate Agents
  - e) Other merchant merchants that the transaction must be at least € 10,000 regardless of the currently complete transaction or multipayment
  - f) Gambling service providers other than Casinos to be assessed by the Member State after assessing the risk of money laundering or terrorist financing. This Directive also introduces an element of the party's in-depth analysis. Primarily EU members prohibit their financial group or credit institutions from running anonymous accounts or anonymous savings. If such accounts or savings exist, they must undergo a deep analysis as soon as possible, especially before they are used.

In other cases, to a deep analysis will be submitted the parties that found themselves in the following situations:

1. A business relationship has been established
2. An occasional transaction has taken place which:
  - a) is at the minimum of € 15,000
  - b) Money assets are part of the transfer of funds described in Art. (3) of Regulation (EU) 2015/847 of the European Parliament and Council and exceeds the amount of € 1000. This would mean that any transaction was carried out at least partially electronically through the providers of cash services in order to transfer the funds to the recipient, irrespective of whether the payer and the recipient are the same people and that includes: credit transfers, direct debits, cash dispatches or a transfer carried out using a card, electronic money, mobile phone, or another digital payment device.
3. Person trading in merchandise cash transactions of at least 10,000 €,
4. A gambling provider that makes a transaction of at least 2,000 €
5. When there is suspicion of money laundering or terrorism financing
6. Where there is doubt as to the accuracy and truthfulness of the information received by the party.

When it comes to the measures taken in the case of a party's in-depth analysis, it is necessary to consider identifying the person and checking that is visible from the documents or information taken from trusted sources, identifying the real owner when the party that so represents itself, in fact, is not, estimating and collecting data on the purpose of business relationship, constant monitoring of specific business relationships, including transaction control as needed. The directive, in its text, foresees that the EU Member States do not necessarily have to apply in-depth measures of depth analysis, at least when it comes to the use of electronic money. In order for an EU Member State to activate such an agreement, it is necessary to meet all of the following conditions defining that the highest amount deposited electronically does not exceed € 250, that the payment model is used solely for the purchase of



goods or services, so that the payment model can not save electronic money from unknown payer, model monitors the transaction enough to detect suspicious transactions and the payment model has no recharge option, i.e. the monthly limit is 250 € and in that form can only be used within the same EU Member State. The element of a simple procedure for the deployment of deep analysis is also incorporated into the legislative concept of the Directive. It refers to cases where the risk assessment of money laundering or terrorism financing is low enough that an EU Member State allows taxpayers to apply a simplified deep-scan procedure measure by checking and tracking transactions and business relationships in order to detect any unusual or suspicious transactions. The Directive also envisages the establishment of Financial Intelligence Units (hereinafter: FIU) for those EU Member States that have not yet done so. FIU is set up to prevent, detect and combat money laundering or terrorism financing. The FIU structure is complex in such a way that the units are independent, have the authority to perform their functions smoothly and make independent decisions, but also serve as a link between the financial and the non-financial sector with the legal and other important authorities. (Cindori, 2007, p. 176) While the state provides them with unharmed access to financial and administrative data, the FIU responds to the authorities. The FIU analytical function consists of operational case-specific analysis and strategic analysis of patterns and trends in the world of money laundering and terrorism financing. The data protection or keeping the records of the parties is defined so that the obligors must keep the documentation and information important for potentially preventing the money laundering or terrorist financing being carried out by the FIU or other competent authorities in the following manner (Cindori, 2014, p. 2):

1. In case of a deep analysis of the party, a copy of the documentation is required to be kept for a period of 5 years from the completed transaction or completed business relationship.
2. Supplementary documentation and transaction reports, including original documents or copies acceptable in court proceedings, which must also be kept in a period of 5 years from the completed transaction or completed business relationship.

When this period expires, EU Member States must ensure that this information is deleted and may be kept for a period of more than 5 years only if it is considered justified and necessary to prevent, detect or investigate certain cases of money laundering or terrorism financing. It is important to underline that in any case, such a type of data stored should not be processed in any other case except for money laundering or terrorism financing, and especially not for commercial purposes. Data processing, in accordance with Directive 95/46 / EC, is considered to be of public interest if used to facilitate the detection of risks, perpetrators, and ways of money laundering or terrorism financing.

*Figure following on the next page*



Picture 1: Anti-Money laundering system in Croatia (*Ured za sprječavanje pranja novca, Financijsko – obavještajna jedinica, Godišnje izvješće o radu 2012*).

#### 4. FINANCIAL ACTION TASK FORCE RECOMMENDATIONS

The Financial Action Task Force (hereinafter referred to as FATF) is a body established in 1989 by EU ministers for the effectiveness of the use of legal and regulatory measures to combat money laundering and terrorism financing. The FATF has transposed a Recommendation Package that is comprehensive and compliant with the International Standards on Combating Money Laundering and Financing Terrorism & Proliferation - The FATF Recommendations (2018) Recommendations deemed necessary and whose implementation should be implemented through national frameworks EU Member States are:

1. Identification of risks and development of strategy and domestic coordination,
2. Persecution for money laundering or financing of terrorism,
3. Apply preventive measures for financial and other related sectors,
4. Establish and provide opportunities and responsibilities to State bodies responsible for Implementing a plan to fight money laundering and financing terrorism,
5. Increase transparency and availability of information on ownership of legal entities,
6. Strengthen international cooperation.

FATF, as one of the goals, feels it is of great importance to lead and maintain productive dialogues with the private sector as well as with non-governmental organizations to ensure the stability and security of the financial system.

##### 4.1. Risk assessment, national cooperation and coordination

The FATF considers it essential to identify, evaluate and to understand, above all, the risks that money laundering and the financing of terrorism represent for one country. Accordingly, all measures to prevent it must be taken, as well as the inclusion of important state bodies and mechanisms in order to control the risk in part. Also, so-called Risk-based approach (hereinafter: RBA) (Seebeck, 2014, powerpoint presentation sld: 4) should be the basis of action in the fight against money laundering and terrorism financing, which means the use of all resources and methodologies that prioritize all activities based on previous data analysis. Through its methodology, the RBA is guided by the following principles: risk determination, data collection, a ranking of importance, risk behavior, performance measurement and acceptance of a tried and tested model.

The first and most important stage is just a risk assessment, and FATF considers it to be the most successful when the financial institution is responsible for this process. Coordination at the national level is a necessity and a recommendation that agencies and other government bodies involved in the fight against money laundering and terrorism financing participate in dealing with this issue on a daily basis and deal with what the FIU, the police and their supreme ministry and other relevant associations which with their competence can contribute to more effective policy and more efficient action. Of course, the importance in this segment also is the general protection of personal data, so that the responsible organizations and associations don't misuse privacy.

#### **4.2. Money laundering and assets or funds seizure**

Money laundering as a criminal offense should be criminalized and penalized in accordance with conventions already adopted; The 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (hereinafter referred to as "the Vienna Convention") and the United Nations Convention against Transnational Organized Crime, the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, and the Anti-Smuggling Protocol migration by land, sea and air, supplementing the United Nations Convention against Transnational Organized Crime (hereinafter: the Palermo Convention) and the legislative measures contained in the International Convention on the Prevention of Terrorism Financing should also be respected so that state authorities freeze or confiscate property or assets of person or companies that have committed a criminal offense of money laundering or terrorism financing. It is even advisable for the EU Member States to consider introducing measures that will enable seizure action without the need for a legitimate verdict on criminal activity or the necessary proof of the legal origin of the defendant's property to the extent required by the domicile law.

#### **4.3. International cooperation**

International co-operation is an important aspect of action in the fight against money laundering. The FATF recommends that countries have to react quickly, constructively and effectively when it comes to international cooperation. The best way to do this is a wide range of joint legal assistance on money laundering, crime forecasts, and persecution. In this aspect, it is necessary for the EU Member States to achieve a high-quality legal basis, to conclude agreements on cooperation with third countries, and in particular to:

1. They shall not forbid international legal assistance or impose unreasonable restrictions on international legal assistance,
2. Ensure transparency of the process and efficiency of the implementation of international legal aid applications,
3. They do not refuse the request for mutual legal assistance from another EU Member State only because it considers that the criminal offense includes fiscal matters,
4. They shall not reject the request for mutual legal assistance on the basis of a legal framework requiring confidentiality or secrecy unless it is expressly and necessary,
5. To respect the confidentiality of the mutual legal assistance request and the information it contains for the purpose of protecting the course of the investigation. In the event that the State from which legal aid is requested is not able to retain such confidential data, it is obliged to notify the applicant State.

In the sphere of mutual international assistance with third countries, goes the extradition of persons who committed a criminal offense of money laundering or terrorist financing. Execution of extradition must be fast and without unnecessary retention.

The EU Member States shouldn't be a safe haven for persons believed to have committed the above-mentioned offense and must:

1. Describe legal framework on extradition of persons,
2. Ensure transparency of the extradition process and prioritize cases where necessary,
3. Ensure that money laundering and terrorism financing is a criminal offense for which a person may be extradited to another state,
4. Reasonably judge the presented extradition requirements.

It is recommended that EU Member States implement such measures by appointing and authorizing appropriate state bodies dealing specifically with the problem of money laundering and terrorism financing, with all available mechanisms, in order to provide the other states with the response to the requested information or some other type of assistance.

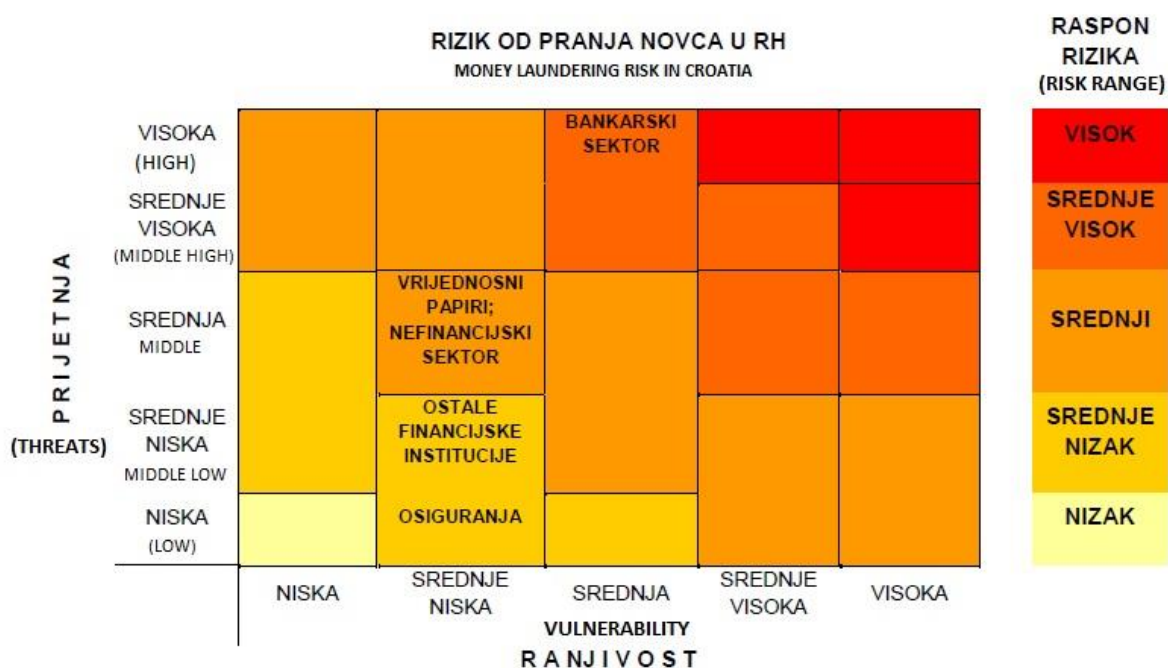
## **5. NATIONAL RISK ASSESSMENT OF MONEY LAUNDERING AND FINANCING OF TERRORISM IN CROATIA**

FATF as an internationally independent body sets certain standards and ways of implementing measures to combat money laundering and terrorist financing. The recommendations made in 2012 have been revised and updated in 2018 and according to the FATF document delivered to EU members as one of the most important recommendations, the risk assessment and the use of risk-based approaches are described as follows: "States should identify and assess the risks to the state of money laundering and terrorism financing and should be well-informed, and should take action, including defining a body or mechanism for coordinating risk assessment actions, and applying resources, all for effective risk reduction. Based on this assessment, states should apply a risk-based approach (RBA) to ensure that measures to prevent or reduce money laundering and terrorist financing are proportionate to the identified risks. This approach should be the basis for an effective allocation of resources within the framework of anti-terrorism prevention and anti-terrorist regimes and the implementation of risk-based measures under the FATF Recommendation. In the case of identifying major risks, States should ensure that their regime of money laundering and the fight against terrorism financing adequately covers and addresses those risks. In the case of identifying smaller risks, States may decide to allow simplified measures for some of the FATF Recommendations under certain circumstances. States should require financial institutions and the non-financial sector and independent professions (DNFBP sector) to identify, assess and take effective actions to reduce the risks of money laundering and terrorist financing. " This approach resulted in identifying the threats and vulnerabilities of the money laundering and terrorism financing system in Croatia. In this regard, the greatest threats to the system are predicate criminal offenses such as:

1. Abuse of trust in economic business,
2. Tax or Customs evasion,
3. Abuse of authority and position,
4. Abuse of narcotic drugs.

In the event of the vulnerability of the money laundering system, the assessment was carried out at the national level in the banking sector, the loan stocks sector, insurance and other financial and non-financial institutions. The most vulnerable sector is banking. The system vulnerability assessment has shown some shortcomings, particularly in the areas of transparency of data on real owners, a small number of criminal cases and investigations or verdicts, lack of administration, and therefore lack statistical data and analysis (Cindori, Petrović, 2016, p. 778). Sanctions to tributaries who do not comply with anti-money laundering laws and terrorism financing are also labeled as system vulnerabilities as well as a small number of reported suspicious transactions in all sectors except banking.

The Croatian legislative framework regulates the proceeding of confiscating assets which are acquired by unlawful acts, in Art. 77. and 78. of the Criminal Code of the Republic of Croatia (hereinafter: CC). In the data available in the reports on the work of state attorneys, it is easy to reach the scale of the number of seized property gains used in relation to the number of adult persons convicted of money laundering. In these calculations it is apparent that the number of convicted persons whose property have been seized because of narcotics abuse is 8%, for the criminal offense of fraud in economic operations and fraud is 3%, for the offense of abuse of office and authority 4%, and abuse of authority in economic activity or tax evasion by about 6%. Withdrawal of property is managed by the State Property Management Office except in the case of funds acquired by selling a deprived property when these funds are paid into the state budget.



Picture 2. Money laundering risk in Croatia (Nacionalna procjena rizika od pranja novca i financiranja terorizma u Republici Hrvatskoj, 2016).

In regard to the reported relations with the Republic of Croatia regarding the risk of money laundering, we can conclude that the banking sector is the most sensitive in this aspect. On the other hand, the risk sensitivity of the loan stock sector is medium and medium-low, which still reflects the presence of money laundering in that sector but to a lesser extent and volume. Among other things, this is why the loan stock sector does not receive cash transactions but execute transactions through accounts held by credit institutions. In addition, the size of the market is modest, a large share of inactive customers and an insignificant share of clients who consider it to be high-risk market in money laundering.

## 6. CONCLUSION

Money laundering is a complex activity that requires more people to participate, coordination and patience while conducting such processes. Money laundering is often used for personal gain but often serves as a tool for financing terrorism. In order to anticipate the intent of the perpetrators of these criminal offenses and successfully track the trail of money trying to infiltrate into legal flows of money, the need is international cooperation and almost blind adherence to the recommendations and measures laid down in the EU Directives that are

proposed by the European Parliament and the Council and which apply in all EU member states. In this process, it is important to cooperate with all the financial and non-financial institutions with EU member state bodies involved in these criminal operations. Also, the maximum allowed transparency regarding the availability of data on real-estate suspect accounts and the regular monitoring of suspicious transactions is required. Corruption is an obstacle to achieving the goals set out in the fight against money laundering and terrorist financing, where individual personal interests may potentially endanger the national security of a country. For this reason, all financial institutions should implement internal anti-corruption measures as well as measures of internal verification of potential money laundering through their institution. Given that the perpetrators of money laundering and terrorism financing don't waste much time in executing their transactions, the efficiency and speed of implementation of these recommendations and measures are of great importance at the international level where special channels should be set up for faster sharing of the necessary information and documents without unnecessary time waiting. On the other hand, the Republic of Croatia is not one of the countries where money laundering is the regular activity of criminals but still exists. According to reports from financial intelligence units and the Money Laundering Prevention Office, the Republic of Croatia conducts international co-operation through a secure Internet data exchange and intelligence exchange system, where the Ministry of Internal Affairs and the Security Intelligence Agency are most frequently involved, which is again regulated by legal frameworks such as the Law on International Legal Assistance in Criminal Matters, Criminal Procedure Act, Act on Judicial Cooperation in Criminal Matters with the Member States of the European Union, International Convention on the Prevention of Terrorist Financing etc. In any case, improvements in the area of anti-money laundering and terrorist financing depend to a large extent on political environments, co-operation of competent bodies, analysis of suspicious transactions, international cooperation and international restrictive measures as well as the financial and non-financial sector.

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## CIVIL SOCIETY IN THE REPUBLIC OF CROATIA

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### ABSTRACT

*The purpose of the paper is the research itself regarding the civil society in the Republic of Croatia. The definition of the civil society and its financing possibilities and also its opportunities, the main advantages and disadvantages have been used in order to assess the benefits and the problems, that the civil society in Croatia is coping with. The major guidelines, regarding the possible steps in improving the situation in plain view of every citizen and the state have been offered, as well as the steps that the public and the state need to undertake in order to ensure the justified recognition which the civil society deserves.*

**Keywords:** *civil society, organisation, state, cooperation, recognition, democratic society, sustainable development, participatory democracy*

### 1. CIVIL SOCIETY IN THE REPUBLIC OF CROATIA

Regarding the fact that the state, with its regulations, sometimes cannot satisfy the needs of its citizens, there are organisations of a civil society that play a key role in societal development which encourage the self regulation in specific areas of the civil interest. Civil society, in fact, is a reflection of the democratic systems, where the citizens have the right to join freely in the specific organisations in order to achieve common general interests, or to be more precise, interests that are on nongovernmental level. These organisations are nongovernmental and non-profit organisations whose main goal is not to gain profit, but in case if the profit is gained they must use it solely to manage and to improve the activities that fulfil the association goals. These kinds of organisation in Croatia are: in the narrow sense – associations, foundations and institutes, and in the broader sense – unions and workers associations, humanitarian associations, religious communities and political parties.

### 2. DEFINITION OF THE CIVIL SOCIETY

The civil society is understood through citizen's activities that, by participating individually or in a group, through programmes and initiatives, are included in the public political processes to represent their interests and needs. Through civil society citizens are defending their personal, political and social rights. Projects and programmes of the civil society are referred to: protection and promotion of human rights, protection of cultural and natural heritage, cooperation between associations of people with disabilities, the fight and safe return of the refugees, the fight against organised crime and corruption, building peace and stability, asylum issues and development of the programmes which protect the environment. The principles that are protecting the civil society are independence, pluralism, multicultural, the freedom to choose the interest orientation, the freedom to speak freely, to assemble, and to form associations and other general activities. The state must respect already mentioned principles, accept criticisms and cooperate with the civil society. Furthermore, the state must respect the civil society as an equal participant in co-deciding when it comes to questions of public interest and implementation of decisions and measures that have a public impact.

### 3. FINANCING OF THE CIVIL SOCIETY ORGANISATIONS

The state and the civil society organisations are achieving concrete forms of cooperation through direct financing, non-direct financing, cooperative democracy and managing specific

activities from the governmental aspect. Direct financing is managed through the state budget, Act on organisation of games of chance and prize games (50% of an annual fee and monthly fee from organising games of chance in casinos, annually and monthly from fees of the prize games, annual and monthly fee from organising chance games, 50% of all the profit of Croatian lottery ltd.), through the National foundation for development of the civil society<sup>1</sup> etc. With the founding of the National foundation for development of the society from the public budget, as well as the use of lottery financial support and international donors, the financial potential is being strengthened which can benefit the sustainable development of the civil society. The non-direct financing refers to tax exemptions, humanitarian aid etc. Cooperative democracy is being fulfilled through active citizens and sustainable development – refers to a need to fulfil a systemic civil education, education of human rights (key terms are democratic society, sustainable development and participatory democracy)<sup>2</sup>. The cooperation between the state and the civil society is being made through the Law on assessment of the effects of regulations. Namely, it is about passing the law which, with its content, can produce significant effects in the area of economy, social welfare, environmental protection, respectably on all fiscal obligations of the Republic of Croatia, regarding the regulation or ordinance in what are the implementing legislations, as well as to proposal of laws and acts of the European Union. The Law on assessment of the effects of regulations, when it comes to civil society, determines the following: rightful informing (to publish the proposals of the regulation which need to be in the Yearly plan of normative activities as well as on the Internet web site to inform the public at least 15 days prior in the period from September 01 to September 30 of the current year for the next year); the obligation to advise when passing regulation (with the public a 30 day rule is mandatory, but also longer if the material is complex, the expert in drafting the regulation has to implement one or more public presentations of the material, to publish the proposal with the content of the regulation thesis on the web page), the obligation of a public debate when the regulation is being passed (with the public and interested public<sup>3</sup>, the deadline for the mentioned is 15 to 30 days, the public presentation as well as publishing on the web page is mandatory. From the formation of the civil society, it has been recognised that the democracy is in danger so it actively participates in the strengthening of the democracy processes. Due to it, it is of high importance to encourage the civil society, by various supports, to create a stimulating environment for its activities and also its further development. The civil society has a significant role in the reallocation of social inequalities when it comes to state, non-governmental institutions and organisation, individuals and group relationships.

#### **4. FREEDOM OF PUBLIC GATHERING**

Civil society organisations have a right for a free public gathering in accordance with the Law on public gathering which is tightly connected with democracy (the statement of pluralism and tolerance). The state cannot interfere in the right for public gathering unless there is probable cause. On the other hand, the state has specific obligations in cases of public gathering: it needs to protect the freedom of public speech and the public performances on peaceful gathering and public protest through law enforcement, it needs to stop interfering or preventing a peaceful gathering and a public protest, however the coercive police measures can only be used in case it is highly necessary and proportional to the nature of risk.

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<sup>1</sup> National foundation is the leading public institution for cooperation, connection and financing of organisations of civil society in Croatia. From the year 2006 the foundation has an internationally recognised certificate for managing the process of awarding the financial support to associations.

<sup>2</sup> Development cooperation through programmes of support can be concluded with public institutions, but also with other non-profit organisations to whom National foundation is giving a professional and financial aid to establish a systemic model of support to civil organisations in their area of expertise, as well as the model of participatory democracy by including citizens and civil society organisations in development of local community

<sup>3</sup> Interested public refers to: citizens, civil society organisations, representatives of the academic community, chambers, public institutions and other legal persons which are performing a public service.

Civil society organisations can act through three types of public gatherings: peaceful gathering and public protest (to publicly state and promote political, social and national beliefs and goals), public show (to raise funds in accordance with their registered business activities), and other forms of public gathering (the purpose being accomplishment of economical, religious, cultural, humanitarian, sports, entertainment and other interests)<sup>4</sup>. The civil society organisations through the mentioned public gatherings are fulfilling their roles and goals. Like the state, the citizens have a specific set of obligations when it comes to participation in a civil society. They have to have a sense of social justice, they need to strive to achieve a general benefit for all citizens, they need to show collegiality and other values when they participate in civil society organisations.

## **5. RELATIONSHIP BETWEEN THE CIVIL SOCIETY AND THE STATE**

Due to the existence of the civil society organisation the role of the state somewhat has changed, in fact it became less significant. The thing is that the process of decentralisation ensued and the local government in cooperation with the civil society organisation has taken over a fair amount of different services and activities to provide a more efficient help to the citizens. By doing this the local government and the non-profit organisations gained independence and self-sustainability which gave them more solidarity amongst the members of society or community. The civil society is based on voluntarily achieving the goals of community and to act for the greater good through individuals, the church, non-profit organisations and similar and still have a significant pressure and supervision over governmental institutions. The fact is that the governmental institutions are somewhat inefficient and corrupted therefore the citizens should not depend on them, moreover through their actions the citizens need to determine their own development path and thus improve their position in the state (especially economically and socially). Thus, there are different organisations of civil society in which the citizens can act in the way they like it but of course having the common goal in mind. An example of a positively implemented process and inclusion of the civil society organisation beliefs was when the Strategy for rural development was made. Also, it can be noticed in concrete cases linked with priority areas in social policy (Cooperative memorandum about social inclusion of Croatia) and in protection of human rights. As a very good example on a local level one can mention the City of Split where, in the process of development and making of “The strategic guidelines for partnership activities in providing social services 2008 – 2012.” a series of experts from the City, public institutions, civil society organisations and economy participated actively. When it comes to cooperation between associations and the state, research showed that the cooperation is mostly achieved on a national rather than local level, where the most common shape of cooperation is financing association from the public sector as well as joint implementation of the projects.<sup>5</sup> Furthermore, research showed that the process of joining the European Union has improved the cooperation between the civil society and the state. Namely, the research in question is a survey that was conducted among the representatives of the civil society organisations. In almost 50% of cases the respondents believe that the process of joining the European Union had a positive impact in the quality of partnership between the civil society and other institutions through improvement of interpersonal relationship, and in nearly 40% of cases the cooperation continued after the initial partnership in the joining period.

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<sup>4</sup> With the mentioned gatherings, the Law on public gathering states that three principles need to be respected: positive presumption for the benefit of public performance, positive commitment of the state to preserve the right to freedom of gathering and the principle of proportionality when limiting the rights to gather freely.

<sup>5</sup> Civil and social dialogue in Croatia

[http://www.socijalnpartnerstvo.hr/UserDocsImages/dokumenti/EURH/4%20sastanak/LPR\\_Civilni\\_i\\_socijalni%20dijalog.pdf](http://www.socijalnpartnerstvo.hr/UserDocsImages/dokumenti/EURH/4%20sastanak/LPR_Civilni_i_socijalni%20dijalog.pdf)

## 6. THE CIVIL SOCIETY ROLE

The role of the civil society organisations consists of next activities: take action to protect human rights and freedoms, environmental, humanitarian, informational, cultural, national, pro birth-rates, educational, social, and vocational, sports, technical, medical, scientifically or other beliefs and goals. All of the above mentioned goals most definitely need to be in accordance with the Constitution of the Republic of Croatia and its laws.

## 7. CRITICISMS OF THE CIVIL SOCIETY

The criticism that is being directed towards the civil society is as follows: political frame to develop the civil society is burdened with the mistrust of the citizens towards the civil society organisation, great ambition of the government to control their work, relatively good legislation but a troublesome application, as well as an insufficient political-legal culture of behaviour of the authorities, too much of centralisation and state interventions, irresponsibility of the authorities, low degree of individual freedom, manipulation on the state of consciousnesses<sup>6</sup>. A long time was needed for the citizens to be encouraged to self organise and stand up for the problems in the community and society. Civil society organisations act in larger urban settlements whilst the potential mobilisation of citizens from smaller settlements is being disregarded. Civil society organisations did not develop cooperation with the economy representatives as important stakeholders in development of the civil society. The civil society organisations are not sufficiently cooperating with the government and local government in preparing, passing and applying different policies, laws and regulations. Also it has been stated that the state does not trust the civil society organisations<sup>7</sup>.

## 8. NECESSARY CHANGES

Civil society organisation, often, are not capable of clearly articulating their views and beliefs and expressing their interests and programmes it is implementing towards the state because they do not have enough expert personnel as well as they lack the networking aspect. Also, an indispensable fact is that they still have a modest impact in creating public policies even when they are included in the process, however their believes, opinions and recommendations are often being disregarded which leads to de-motivation in future involvement. Having the mentioned situation in mind the society needs to change as well as the state. Regarding the above mentioned, the civil society organisation need to do the following: create a better and more efficient cooperation, network better, act together, develop cooperation with the media, raise the citizens awareness, constantly educate themselves, be more transparent when it comes to showing their work through programmes and project etc. On the other hand the state needs to do the following: accept civil society organisations as equals and independent associates and respect their opinions and critique, perform consultation activities, recognise and appreciate the work and effort of the civil society organisations, determine clear criteria regarding inclusion of the civil society organisations in creation of public policies etc. Civil society organisations are contributors to the democratization, protection of human rights and empowering the rule of the law. In the same way, the non-governmental sector represents an efficient source of income to the public budget and creation of new employment opportunities. The dialogue between the state and the civil society is limited, not systemic enough. In most cases the state is looking for easy ways to avoid consultation with the civil society. The civil society organisations have a modest impact in creation of the public policies because they are rarely invited to participate in the preparation processes, passing process and implementation of the law and policies.

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<sup>6</sup> Manipulation on the state of consciousness is referred to the feeling of helplessness, insignificance and discouragement, the feeling of fear, isolation and vulnerability, the feeling of scarcity and the threat of losing competitiveness or extinction, responsibility for failure

<sup>7</sup> Siniša Zrinščak i Gojko Bežovan: Is the civil society becoming a factor in social change in Croatia, Social policy review Vol. 14, No. 1, 2007., pp. 6.

Civil society organisations are extremely important in the process of European integration because they can help in speeding up the reforms; they represent a wide audience with a specific area of interest. The cooperation between civil society organisations and the state represents the most efficient way in shaping public policies which are a foundation in finding a common solution to develop economically, socially, to contribute to the increase in employment possibilities and social safety to preserve the environment, to protect the human rights and fundamental freedoms as well as to achieve humanitarian, sport, scientific and other goals.

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## SOME ASPECTS OF CIVIL AND CRIMINAL LAW REGULATION OF FOOD QUALITY – CROATIAN AND EUROPEAN POINT OF VIEW

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### ABSTRACT

*In the consumer protection regime, there are three legal instruments applied, criminal law, civil law and finally administrative law instrument. EU consumer legislation aims at ensuring that products are safe, that consumers are properly informed as to the nature and characteristics of products, and that they are not misled through unfair commercial practices. This article provides information and describes the current situation of food safety and quality in Croatia. Paper analyzes some problems, first of all Croatian consumers have the right to know whether, and, if so, what differences exist in the quality of foods sold under the same name in the „old Member States“ and the ‘new Member States’. Identically, branded products which are advertised and sold as being the same in different Member States should not in fact have a lower quality in one country or another. The European Commission published a notice laying out guidelines on the application of EU food and consumer protection law to issues of dual quality of food products on 26 September 2017. The Commission Notice on dual quality contains quite specific clues about the future approach of the measures that will be adopted to resolve the complicated problem of the marketing of differentiated food products in the Single Market. Consumer protection regime encompasses also sanctions in Croatian legal system mostly using forms of misdemeanor. Responsibility for criminal offence can be found, but using in consideration fact that foods sold in „new Member States“ is in accordance with health standards, so exists smaller legal good threat or injury, this article analyzes misdemeanor in Croatian Food Act, The Law on Ban on Discriminatory Practices in the Supply Chain, Consumer Food Information Act and Consumer Protection Act.*

**Keywords:** *civil liability, consumers, food quality, misdemeanor, unfair commercial practices*

### 1. INTRODUCTION

In the last decade lawmaking in the field of European union (hereinafter: EU) consumer law has been particularly intense. The Republic of Croatia has incorporated a high level of consumer protection into the provisions of the Consumer Protection Act (Official Gazette 41/14, 110/15, hereinafter: CPA) including the European Directive on Consumer Rights (2011/83/EU), which become a common standard of consumer rights protection throughout the EU, with application in all Member States since 13 June 2014, and its provisions are fully transposed into the Croatian CPA (Ružić, Šutić, 2017, p. 1.). EU laws are aimed at ensuring that all products placed on the internal market are safe for consumers. This is considered to be a precondition for the free movement of goods which is one of the four fundamental freedoms of the Single Market (Šago, 2013, p. 115-116). The safety of some products is harmonised at EU level by sector-specific legislation (e.g. cosmetics, vehicles, toys, ...). Certain safety aspects not covered by the sector-specific legislation, and the safety of products not harmonised at EU level, are governed by the 2001 General Product Safety Directive. Food safety is regulated by a separate set of

legislation, foremost being the 2002 General Food Law Regulation. It lays down rules for protecting public health by prescribing that no unsafe food, food that is harmful to health and unfit for human consumption, may be placed on the internal market. It also lays down principles for protecting the interests of consumers by banning fraudulent, deceptive and misleading practices and the adulteration of food.

## **2. THE LEGAL FRAMEWORK FOR FOOD SAFETY AND QUALITY**

The legal framework for food safety in Croatia is provided by the Food Act (Official Gazette 81/2013, 14/2014, 30/2015, hereinafter: FA), which transposes the provisions of Regulation (EC) No. 178/2002 of 28 January 2002 laying down the general principles and requirements of food law, establishing the European Food Safety Authority and laying down procedures in matters of food safety. The FA and implementing regulation based on it are legislative framework for ensuring food safety and quality in Croatia. The FA prescribed general principles relating to the hygiene and safety of food and feed, obligations of the food business operators regarding setting up and implementation of self-control system, general principles on food quality, obtaining the registration of geographical indications and designation of origin and the traditional reputation of the food, regulate area of novel food (including also genetically modified food), system of official control and foundation and role of Croatian Food Agency (Pišonić, Rukavina, Volar – Pantić, 2005, p. 1.). According to Article 60 of Regulation (EC) No. 178/2002 without prejudice to the application of other Community provisions, where a Member State is of the opinion that a measure taken by another Member State in the field of food safety is either incompatible with this Regulation or is likely to affect the functioning of the internal market, it shall refer the matter to the Commission, which will immediately inform the other Member State concerned. The two Member States concerned and the Commission shall make every effort to solve the problem. If agreement cannot be reached, the Commission may request an opinion on any relevant contentious scientific issue from the Authority. The terms of that request and the time limit within which the Authority is requested to give its opinion shall be established by mutual agreement between the Commission and the Authority, after consulting the two Member States concerned. Infringement of food regulations can lead to measures under criminal law and consumer damage claims under civil law, whereby the final decision rests with the courts. Government measures with regard to food safety are often based on scientific risk assessment. However, the final decision on the legality of governmental measures rests with the courts. The governance of food safety in Croatia has evolved significantly in the past two decades. The evolution has affected the way in which food safety is assured globally. Food safety assurance is achieved through two main ways: statutory regulation and private regulation. Statutory regulations for food control primarily protect the health of consumers and spell out behaviours, mechanisms for enforcing them, and sanctions that should be applied. Private regulation of food safety is linked to the trend of major retailer. Most of the standards are similar in the sense that they all have one main objective: to protect consumer health through an integrated process-based food safety management, achieved through specifying the basic minimum requirements acceptable for food safety and third party audits (Knežević, Đugum, Frece, 2013, p. 214.). The European legislator strives to guarantee on the one hand a high level of consumer protection from problems related to the safety and to safeguard their economic interests, on the other hand it aims to ensure the access to the market and the possibility to choose various products (Edinger, 2013, p. 135 – 136). According to Article 4 of the FA “food quality” shall mean the aggregate characteristics of food that bear on its ability to satisfy the needs of the final consumer. Also, according to Article 35 food business operators shall be allowed to produce and place on the market foodstuffs of compulsory quality, including the foodstuffs without provided quality requirements, if the food meets the requirements of the provisions on safety and the information in the declaration.

The Minister of Agriculture and Forestry with a previously received opinion from the Minister of Health shall adopt the implemented regulations which regulate food quality for the purpose of: protecting the interests of the consumer; enabling the consumers to make a selection regarding the food which they consume. The implemented regulations shall establish the requirements regarding: 1. the classification, categorisation and terminology of foodstuffs, 2. the sensor characteristics and composition of foodstuffs, 3. the sort and quality of raw materials, additives and other materials used in the production and processing of foodstuffs, 4. technological procedures applied in the production and processing of foodstuffs, 5. methods of sampling and analytical methods for the purpose of controlling food quality, 6. additional or specific data that needs to be specified on the food label. Official control of food quality shall include one or more of the following activities: inspection; sampling and analysis and examination of the contents of declarations, written materials and documents.

### **3. THE UNFAIR COMMERCIAL PRACTICES - THE EQUAL TREATMENT OF CONSUMERS**

#### **3.1. Application of the unfair commercial practices directive**

The Unfair Commercial Practices Directive (hereinafter: UCPD) adopted in 2005, is the main horizontal piece of European Union (EU) legislation regulating misleading advertising and other unfair practices in business, to consumer transactions, and applies to all unfair commercial practices on and off - line that occur before, during and after a business – to - consumer transaction has taken place (Valant, 2017, p. 1.). This Directive protects average consumers from commercial practices that materially distort their economic behaviour, for example causing them to buy a product they otherwise would not buy. Goods of the same brand and having the same or similar packaging may differ as to their composition depending on the place of manufacture and the destination market, they may vary from one Member State to another. Under the UCPD, commercial practices marketing products with a different composition are not unfair per se. However, were a trader to promote a product as being of the same composition and quality as particular products in another Member State, that could be considered misleading if it would cause the average consumer to buy a product he or she would not otherwise buy. The free movement of goods does not necessarily mean that every product must be identical in every corner of the Single Market. For certain categories of branded products such as perfumes, luxury goods, cars, people are looking for exactly the same products and fear counterfeits. It can be inferred that a similar behaviour may exist for all kinds of consumer goods. However, for food and drink operators, a ‘constant quality’ does not necessarily mean identical products across the different geographical areas. It is common for food business operators to tailor their products to local consumer preferences and other conditions. In particular, sensory optimisations are performed to fit dietary habits that may be very different from one region to another. Furthermore, there may be objective differences in sourcing, due to the geographical and, or seasonal availability of raw materials (specific local requirements), that have an effect on the composition or taste of products and that are therefore difficult to avoid for producers. There may also be the introduction of new recipes to reflect technological progress or nutritional reformulation policies, which cannot technically or economically be done simultaneously in all markets. Least but not last, food business operators may also adapt the composition of products to the price elasticity of local demand.

#### **3.2. Dual quality of branded food products**

The issue of so-called “dual food” has been pushed up the agenda of the commission thanks to lobbying by eastern states Bulgaria, Slovakia, the Czech Republic and Hungary, which have all recently published comparative studies. The consumers of some of the newest Member States of the European Union have been complaining that goods of a lower quality to those in other



EU countries are being sold in their domestic markets. This fact, consisting of the sale of differentiated food products or products with a dual quality, was qualified as unacceptable by the President of the European Commission, Jean-Claude Juncker, in his State of the Union Address on 13 September 2017, saying: «I will not accept that in some parts of Europe people are sold food of lower quality than in other countries, despite the packaging and branding being identical. We must now equip national authorities with stronger powers to cut out these illegal practices wherever they exist». Presenting two different products in the same branded packaging is misleading and unfair to consumers. The companies deny any suggestion they have misled consumers. They claim the ingredients of their products are different only because of consumer preferences. They claim that they are adapting the product for the national taste, and they are producing products for local markets using local products. This means that “Local tastes” are: more sugar, lower percentage of fruit, lower percentage of meat; never vice-versa. For example, for detergents, they say they are adapting the product for the water because there is hard and soft water. From fruit drinks and fish fingers to detergents and luncheon meats, the eastern versions of brands sold across Europe have repeatedly been found to be inferior in quality to those sold in the west, even when they are wrapped in exactly the same branding.

The differences that were found can be divided into few categories:

1. products which contained less of the main ingredient – less fish in fish fingers, less strawberries in strawberry yoghurt, fewer meatballs in a soup, less tuna in a tuna pâté;
2. products which contained ingredients estimated as less healthy – this mainly referred to the use of sweeteners instead of sugar, greater use of preservatives, artificial flavours and flavour enhancers, mechanically deboned turkey and chicken meat in hotdogs; less vegetables and less rapeseed oil in baby food;
3. products with different sensory characteristics: differences in colour, taste and texture in hotdogs, easier to spread bread paste, crunchier wafers;
4. other issues, such as packages with smaller quantities, and under-performing packaging in terms of preserving taste (Šajn, 2017, p. 2.).

Food business operators shall be allowed to produce and place on the market foodstuffs of compulsory quality, including the foodstuffs without provided quality requirements, if the food meets the requirements of the provisions on safety and the information in the declaration. It's not only about that consumers are feeling as a “second class” citizens, it's about their rights and possibilities to have greater influence in decision making at EU level. In partnership with European consumer protection institutions, we need to find possible solutions to end consumer discrimination in eastern Member States. While the ingredients were generally properly labelled and the products were considered safe for consumption, some of those in 'new' Member States were considered to be of inferior quality and less healthy, and were also more expensive. Similar claims have previously been made concerning cosmetics and laundry detergents (Šajn, 2017, p. 1.). The responsibility for the proper labelling, advertising, and the accuracy of the data presented is how the manufacturer and the dealer or another entity that puts food on the market, based in the EU (Proso, Sokanović, 2015, p. 23-26).

### **3.3. The commission notice on dual quality**

The EU has developed a comprehensive legislative framework to safeguard consumer rights. Effective consumer protection is essential for an efficient and well-functioning market. This framework includes the protection of consumers against misleading information and commercial practices (Commission Notice of 26. 9. 2017. on the application of EU food and consumer protection law to issues of Dual Quality of products – The specific case of food, 2017, p. 1.). The aim of the Commission Notice on dual quality is to facilitate the practical application of current legislation.

The section of the Commission Notice on dual quality entitled “Main characteristics considered by consumers when buying branded products” includes some interesting points:

1. the existence of one or several branded products in the general offer of a specific category of processed food products (for example, coffee, tea, chocolate, ...) influences most consumers when making their choice and, in this context, «the transactional decision of a consumer for a branded product is, to a large extent, based on his/her perception of what this brand represents for him/her» and, moreover, when «concerning foods, this is a subjective opinion formed through the sensory experience of each consumer, their dietary preferences, and through factors such as exposure to brand advertising and image building efforts»;
2. the average consumer might not buy a branded product if they have reason to believe that the product purchased does not correspond to their perception of what the branded product should be; and
3. the difficulty in identifying the presence of possible misleading elements in the commercial communication of the branded products lies in that the creators of the brand do not include in an objective, explicit and measurable description the characteristics perceived as “branded” in a specific product, but these characteristics are instead suggested to consumers through various media in a non-explicit way, or via generic claims about the product that conform to their brand name or to that which has made them prosper over time.

### **3.4. Food quality in Croatia**

The Croatian Food Agency announced in May 2016 that it would do its own tests on products in Croatia and Germany. The 26 products to be tested were chosen by participants in a survey conducted by the Croatian Food Agency and the GfK polling agency. That list includes also cleaning products (laundry detergent, fabric softener, universal cleaner) and cosmetics (shower gel and toothpaste). An analysis of the quality has shown that more than half of those products on the Croatian market are of poorer quality and significantly more expensive than in Germany. The survey conducted in cooperation with the Croatian Food Agency in several accredited laboratories in the country showed that only 4 of the 26 products tested (15%) did not differ in quality or price. A difference in quality was identified in 54% of the products while more than 60% of the products were more expensive in Croatia. The greatest differences were identified in food products and one detergent. Some of the products were produced in the same factory, which means that there are two production lines in them. Wudy sausages on the Croatian market for instance use mechanically separated meat and contain polyphosphate additives and are different in colour, taste and texture from the German product, where fresh meat is used. Their price in Croatia is 37% lower. Hipp baby food tested in Croatia, a rice and carrot with turkey variety, showed that the product in Croatia contained significantly less vegetables and a much greater quantity of rice and that it contained less beet oil. Despite these differences, the products carried the same labels on both markets and in Croatia they were generally 54% more expensive than in Germany. A significant difference was identified in Nutella, with whey being used in the Croatian product, whereas the same product in Germany was made exclusively with skimmed milk and it was 28% more expensive in Croatia. Fruit yogurt in Croatia contains less fruit and more sugar, the analysis shows. Also, there was a significant difference identified in Ariel washing detergent, with the German product being much more effective and it was 25% cheaper in Germany. The testing showed that there was very little difference between Heineken beer and Coca Cola despite the fact that they were produced by different manufacturers. Four products proved to be the same in quality and price: Happy Day 100% orange juice, Red Bull, Barilla spaghetti and Lenor fabric softener. Some products were equal in quality but much expensive in Croatia such as Pringles Original Chips, Colgate toothpaste, and Rio Mare tuna

products. Only one product was of better quality in Croatia than Germany, Haribo Happy Cola sweets, which had more sugar content in the German variety.

#### **4. CRIMINAL ASPECT OF CONSUMER RIGHT PROTECTION**

When we are analyzing criminal aspect of consumer protection, first we need to see regulation of FA that regulates food safety requirements. Food that is harmful to human health is considered to be food that is improper. This type of food contains nutritional additives and flavorings which are unauthorized in a given category of food or are permitted but exceed the maximum permitted quantities prescribed by special regulations. This requirement should not be disrupted because foods should pass tests in national states before it comes to shelves. When we are speaking about different quality of food on different markets in EU, FA probably won't be relevant because different quality shouldn't mean food that is harmful for human health. Article 16 of Regulation (EC) No 178/2002 of the European Parliament and of the Council defines presentation. It means that without prejudice to the specific provisions of the food, animal marking, advertising and presentation of foods or animal feed, including its shape, appearance or packaging, the materials used for packaging, the way it is designed or the environment in which it is exposed, and information about it using any medium should not mislead the consumer. Mentioned FA in Croatia regulates punishment with fine of 50 000,00 to 100 000,00 HRK for legal person if breaches mentioned provision of (EC) No 178/2002 that refers on labeling, advertising and presentation of food. Another Act in Art. 4., Act on Ban of Discriminatory Practices (hereinafter: ABDP), regulates improper trading as unfair trading practices in supply chain. Unfair commercial practices within the meaning of ABDP may exist in relationships between suppliers and buyers and / or processors and - between suppliers and retailers. This Act protects consumers indirectly. Also other unfair trading practices in relation to suppliers and redemptors and / or processors in trade of agricultural or food products are non-transparent reduction of quantity and / or value of agricultural or food products of standard quality. If addressees of these provisions do not act according to provisions in ABDP, than administrative-penal measures can be applied. Administrative-penal measures that authorized Agency imposes for the purposes of this Act should protect fair trade practices that protect participants in the supply chain, punish perpetrators of the injury and deter perpetrator and other persons from the violation of this Act. According to ABDP, some administrative-penal measures are prescribed for severe but also for easier violations. Criteria for selection of administrative-penal measures for perpetrator are prescribed in Article 27. In determination and sentence with administrative-criminal measures, Agency shall take into account severity of injury, extent of the injury, duration of injury and its consequences. Administrative-penal measure shall be reduced or increased depending on mitigating and / or aggravating circumstances. Mitigating circumstances are submission of evidence of termination of unlawful conduct before the initiation of the proceedings within meaning of ABDP, providing proof of termination of unlawful conduct no later than within three months from date of initiation of proceedings for the purposes of this Act, short duration of injury, but not longer than a year, and good cooperation with Agency during the proceedings. Aggravating circumstances are perpetrators repetition of same or other conduct that violates provisions of this Act if previously is established violation of ABDP and selected and sentenced with prescribed administrative-criminal measure. Amount of administrative penal measure may be increased in case of finding same violation of Act up to 100%, and for each other case of violation of this Act may be increased by up to 50%, but in this case administrative penal measure can not exceed highest prescribed amount in some Articles. Refusal of cooperation with Agency or obstruction of Agency during the proceedings, role of other instigators in violation of this Act, or any act undertaken to ensure the participation of others in the violation. Agency may further reduce amount of administrative punishment to a legal person in a difficult financial situation if it

submits to the Agency relevant evidence to impose an administrative-penal measure in the amount as provided for by this Act, significantly jeopardized its economic viability (Proso, Sokačević, 2015, p.31) and leads to a significant loss in the value of its assets.

## **5. LEGAL THEORY AND MISDEMEANOUR SEVERITY**

According to legal theory, difference between misdemeanors and criminal offenses is of quantitative nature and depends on criminal-political will of the legislator who, taking into account degree of their severity, determines whether there is criminal offense or misdemeanor (Horvatić, 1999, p. 429-443). Repetition of prescribed violations should be in line with real danger of certain behaviors for legal order, social discipline, value, property, rights and freedoms that are protected by this part of law. If we start from difference in substantive, qualitative difference between certain types of punishable behaviors or different intensities of essentially the same impropriety in behavior, we do not come to a satisfactory response, and consequently it is only a quantitative difference. This is also in line with definition of a misdemeanor in Misdemeanor Act from 2007. (hereinafter: MA) according to which misdemeanor violates public order, social discipline or other social values. Its protection is not possible without misdemeanor sanction, and their protection is not enforced through criminal law enforcement (Vukušić, 2014, p. 930). Definition of misdemeanor has remained negative and subordinate to criminal offense (Derenčinović, Gulišija, Dragičević Prtenjača, 2013, p. 753-754.). From this negative definition of the concept of misdemeanor, there are violations of those values that are not protected by system of criminal law in the narrow sense. Legislator, in our opinion, at prescribing misdemeanour in protecting consumer rights maintained criteria set in case *Engel v. The Netherlands* by the judgment of ESLJ in the 1976. According to these criteria, it is important whether legal system of the state is governed by provisions that determine punitive conduct in criminal law, disciplinary law, or both. It is necessary to consider nature of punishable act which is a factor of greater importance and degree of severity of prescribed sentence, with sentence of deprivation of freedom as sanction falling within criminal sphere. Relationship between criminal offense and misdemeanor can also be observed through four different criteria (Kurtović Mišić, Krstulović Dragičević, 2014, p. 32-33): definition, legal acts prescribed by, bodies responsible for proceedings and sanctions that are prescribed. Definitions are clear but criminal offenses can only be prescribed by Act and can never be prescribed by legal acts of lower rank. Misdemeanors and penalties for them are prescribed by Act and by other forms of legal act's such as regulations, decisions, regulations, etc.. Procedure for criminal offense and application of criminal sanction can only be carried out by court (competent court), while for misdemeanor not only courts but also various administrative bodies (Customs Administration, Tax Administration of the Ministry of Finance, different inspection services ...) are involved in sentence. Most serious punishments (such as long-term imprisonment) and other criminal sanctions are prescribed for criminal offenses, while for misdemeanor are mostly prescribed fines, and exceptionally punishment of imprisonment (Derenčinović, 1999, p. 469) for a maximum of 90 days (Radić; Radina, 2014., p.742).

## **6. CULPABILITY AS LEGAL BASIS FOR SANCTIONS**

In order to apply criminal sanctions on perpetrator, it is important to establish culpability as one of four formal elements of misdemeanor. Culpability towards Art. 25. of MA exists by perpetrator who had mental capacity at time of perpetration, who was negligent and was aware of misdemeanor and was aware of or was obliged to be aware that misdemeanor was forbidden. Exceptionally, it is possible to prescribe that misdemeanor can be committed only with intention.

## **7. EASIER SANCTION – THE BEST SANCTION?**

General purpose of misdemeanor sanctions is prescribed in Article 6. of MA. When legislator prescribes or other authorised body enforces misdemeanor sanctions, their aim is that all citizens respect legal system and that no one commits misdemeanor, and that perpetrator of misdemeanor behaves in the future. Limits in prescribing and applying misdemeanor sanctions refers on determination of content of misdemeanor sanctions and manner of their application so that perpetrator of a misdemeanor may be limited to his or her liberties and rights only to extent that it corresponds to type of misdemeanor sanction and its purpose prescribed by law without causing bodily or mental suffering, inhuman or degrading treatment with respect for human dignity and personality. Misdemeanor sanctions can be prescribed in legal documents that prescribes misdemeanors. Those sanctions are penalty (fine and imprisonment) and safeguard measures in accordance with Article 50 of MA. Misdemeanor sanctions prescribed only in MA are non – custodial sanctions (judicial admonition and suspended sentence), protective measures (Article 50, paragraph 1) and educational measures. Statute of limitation for misdemeanor persecution expires after four years exceptionally misdemeanor persecution expires after three years for misdemeanour for which is possible to issue misdemeanor warrant. Statute of limitation for misdemeanor persecution begins to run on day misdemeanor is committed. Effective sanction for this type of misdemeanors, and sanctions that protect consumers rights described in this paper is protective measure of prohibition complete or partial performance of a particular activity or business for a period of three months to one year to the defendant legal entity who committed misdemeanor in performance of an activity or business if there is a risk of recidivism. Also, another effective sanction, that court may impose is protective measure of prohibition of total or partial acquisition of licenses, powers, concessions or subsidies for a period of three months to one year, to the legal entity that committed misdemeanor in process of acquiring the license, authority, concession or subsidy or use thereof, if there is danger that acquisition of a license, authority, concession or subsidy will re-commit a breach.

## **8. ACT IN FAVOUR OF PERPETRATOR**

General purpose of misdemeanor sanctions, as it is mentioned, should be achieved through imposition of sanctions, that all citizens respect legal system, that no one commits misdemeanor and that perpetrators of misdemeanors are behaving in accordance with law in the future (Article 6 of the MA). Fine may be prescribed alone or as an alternative punishment with imprisonment sentence for some misdemeanor. MA prescribes general frameworks for punishments for misdemeanors, as well as range of amount (framework) for fines (Article 33 of MA). Most legal acts in which misdemeanors are prescribed are respecting these general frames of MA for punishment towards principle of legality in national and european law (Krstulović Dragičević; Sokanović, 2017, p. 45). However, certain regulations (and therefore the laws and decisions of the local and regional self-government units) exceed general provision of MA's framework for sanctions, either by prescribing special minimum smaller than framework prescribed by MA for a particular category of defendant or prescribing higher special maximum than general maximum prescribed by MA. Definitely, defendant can't be punished over general maximum prescribed in MA. But if special Act (it's special minimum) is more favorable for defendant than general minimum prescribed in MA in that case special Act will be applied (Novak Hrgović; Nikšić, 2016, p. 15).

## **9. HISTORY DEVELOPMENT OF FINE**

Fine is a misdemeanor sanction consisting in perpetrator's obligation to pay certain amount of money in favor of state within certain time. Fine imposes a compulsory relationship in which state appears as a creditor and perpetrator as a debtor (Petrović, Jovašević, 2005, p. 299-300).

Financial penalty was created early in the period of private revenge in ransom. The state favored ransom because one part of funds collected belonged to her for mediation between injured party and perpetrator of criminal offense and other part to injured party. Over time, these effects of ransom granted autonomy, so that first part was turned into a financial punishment of public law and compensation for damages of a civil nature. Later, confiscation of property became the subject of violent confiscation of property values and rights. Both fines and confiscation of property fall into penalties that came very early in criminal law and were widely applied in 19th century. Since French Revolution, it lost its fiscal character and its application narrowed (Petrović, Jovašević, 2005, p. 299-300).

### **9.1. Advantages and disadvantages of fine**

In legal theory, there is argument that fine is not of personal character, for example, members of perpetrator family who are not guilty for the perpetrated misdemeanor are affected by its execution. Different situation is in case of confiscation of pecuniary gain acquired by a criminal offense (Ivičević, 2004, p. 165-166). Their unrighteousness is filled with them because they are more likely to hit the poor ones than the wealthy and less wealthy perpetrators of misdemeanor. Opposite argumentation points that this argument is not valid because determination of property fines is executed with regard to property of the perpetrator of misdemeanor, taking into account number of family members who have resided or lived out of his property (Petrović, Jovašević, 2005, p. 299-300). Another disadvantage is possibility of avoiding fines for debt, gifts, termination of employment or loss of income in another way. Recognizing this possibility, money-launderers point out fact that in such case there is a possibility that fine will be replaced by a prison sentence. Opponents of fines also emphasize that fine doesn't affect perpetrator of criminal offense because fine does not affect the cause of criminal activity (Petrović, Jovašević, 2005, p.299-300). Also some emphasize the fact that other penalties do not always affect the causes of crime. Although fines may be attributed to certain objections, it is nevertheless considered a suitable means for combating offense. Fine for perpetrator also has some benefits because fine eliminates negative consequences of short time prison sentence.(Carić, 2002, p.100) and their execution (Plečić, 2012, p. 114).

### **9.2. Supplementary punishment**

A fine imposed as supplementary punishment has also punitive character. It has been observed that, in spite of its sparse treatment in the Croatian legal literature, from a few years ago its application has become more frequent in jurisprudence of the Croatian courts for criminal offenses which sets a new trend (Dragičević Prtenjača, 2016, p. 92). This trend can lead to higher amounts of fines that are imposed for perpetrators of misdemeanor.

## **10. RANGE OF PUNISHMENT**

General rule of selection of type and range of punishment states that choice of type and range of punishment to perpetrator shall be selected by court or other authorized body within the limits determined by MA for the misdemeanor committed is based on degree of culpability, danger of the misdemeanor and purpose of the punishment. Selecting the type and range of sentence to apply, the court will take into account all circumstances that affect type and range of sentence by type and measure being easier or more severe for the perpetrator of misdemeanor (mitigating and aggravating circumstances), and in particular: the degree of culpability, earlier behavior of the perpetrator, his behavior after the misdemeanor commission, and the totality of the social and personal causes that have contributed to the commission of the misdemeanor. By sentencing fine, the court or other authorized body will take into account perpetrator property status. Mitigation of punishment in Article 37 of MA prescribes that court or other authorized body may impose punishment smaller than special minimum prescribed for a particular misdemeanor

when it is expressly allowed by MA. Fine imposed on particular misdemeanor may be imposed by court even if there are particular mitigating circumstances, particularly if perpetrator is reconciled with the injured party, if he has fully or in part reimbursed the damage caused by misdemeanor and the purpose of punishment can also be achieved with such a milder fine.

## 11. CONCLUSION

Food placed on the market must be safe for consumption, must have good quality and not cause human diseases. Croatia has formally adopted a number of typical elements of food safety regulations and control systems in the accession period to the EU. The Consumer Protection Cooperation (CPC) Regulation (EC) No 2006/2004 establishes clear mutual assistance obligations between competent authorities to make sure that the authorities of the Member State where the trader is established take the necessary measures to cease infringements which affect consumers in other jurisdictions of the Union. The Regulation also sets out the obligation for authorities across the EU to alert each other about possible infringements and to exchange information about such infringements. In case of misleading information on the characteristics of a food product, the CPC authorities of the country where consumers may be harmed, should make full use of the tools provided by the CPC Regulation and ask for the assistance of their counterpart authority(ies) of the country where the trader is located. In this connection, the new CPC Regulation, which will be applicable in the EU by the end of 2019, has strengthened the cooperation and surveillance mechanisms of the current system and it will make it possible to exchange information and alerts on infringements across the EU in a more rapid and effective manner. In 2016 the Commission issued guidance on the UCPD, explicitly stating that the practice should not be considered illegal unless a trader advertised a product as being the same as in another Member State, while at the same time deliberately reducing the quality of the product in one country as compared to that sold in the other. To be considered illegal, such a practice would need to be likely to deceive the average consumer and make them buy a product they otherwise would not buy. In 2016, the Commission called on Member States to communicate instances of dual quality of food to the relevant national authorities and to the Commission itself. In its conclusions of March 2017, the Commission decided to address the issue in the High Level Forum for a better functioning food supply chain, enabling a discussion between consumers, producers, Member States and the Commission (Šajn, 2017, p. 7.). Regarding misdemeanour aspect of protection of food safety in Croatia, we can conclude that predicted sanctions for misdemeanours are appropriate so that only measure State can do is to apply them according to principle of legality. Regarding European Commission guidelines on dual quality of branded food product where flowchart explains how to assess potentially unfair business practices and how there is no breach of UCPD if consumer is sufficiently informed about difference that product's composition is significantly different from the version sold in other parts of the Single Market definitely isn't appropriate because this does not present protection of consumer rights. This flowchart only explains that different quality is allowed under condition that consumer is informed about dual quality what isn't acceptable. Finally we can say that Croatian citizens are in an unfavourable position, like most citizens in new EU Member States that are mostly Eastern European countries. It is obvious that, that problem exists everywhere and that national governments are not handling this well and that is why it is important to raise the problem to the European level. We can say that despite the fact that EU agreements guarantee equality, it seems that all European citizens aren't treated equally. The aim is to change legislation to identify unfair trade practice and so all citizens on a single European market are treated the same.

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## DYNAMICS AND FACTORS OF BUSINESS SUCCESS OF MIDDLE-SIZED ‘GAZELLE ENTERPRISES’ IN RUSSIA

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### ABSTRACT

*The success of medium-sized businesses in Russia is overwhelmingly determined by the presence of so-called “star” enterprises. By their very existence and development, they prove the possibility of successful achievement and show other start-up enterprises the path to success. ‘Gazelle enterprises’ or gazelles (fast-growing enterprises) are an example of such entrepreneurial leaders. This article analyses the success of fast-growing enterprises’ in Russia on the basis of financial statements in comparison with the success of “ordinary” medium-scale businesses from 2009 to 2013. The results conclude that rapid growth is more typical of “younger” enterprises and that fast-growing enterprises have a much higher share of added value in revenue. The ability to generate added value contributes to rapid growth in the future. Comparing the profitability of sales between typical and fast-growing enterprises elucidates which ‘gazelle enterprises’ were proven to be more successful according to growth ability and profit-generating ability.*

**Keywords:** *fast-growing enterprises, ‘gazelle enterprises’, small and medium-sized business, business success, business success factors*

### 1. INTRODUCTION

The development of innovation clusters and rapid growth most likely occur in medium-sized enterprises which are both flexible and possess sufficient funds to implement innovative and entrepreneurial ideas. In the first place, medium-sized enterprises which have achieved this kind of rapid success should be studied in terms of their practices and experiences. However, until recently the experience of medium-scale ‘gazelle enterprises’ has rarely been examined. The aim of this article is to analyze the characteristic features of ‘gazelle enterprises’ as mid-sized business units and to single out the most promising enterprises and industries in the hope that their experience will be applied to work out the development strategy of Russian enterprises. This was achieved by conducting an empirical study of mid-sized enterprises throughout Russia on the basis of the enterprises’ financial statements.

### 2. LITERATURE REVIEW

The theory of fast-growing enterprises and the author of the term ‘gazelle enterprises’ comes from D. Birch (Birch, 1981, 2006). He is consistently promoting his theory on the leading role of fast-growing enterprises in creating new jobs and, as a result, economic growth. Empirical studies in different countries have confirmed D. Birch’s findings, as evidenced by the studies in Table 1. However, studies that focused on different factors for rapid growth in the 1990s and early 2000s can be found in Table 2.

*Table following on the next page*

*Table 1: Studies confirming D. Birch's findings*

Country	Subject of Research	Citation
USA	Growth factors of the American manufacturing enterprises	(Acs & Audretsch, 1990)
Turkey	Success factors in Turkish fast-growing enterprises	(Acar, 1993)
UK	British enterprises in the 1980s	(Dunne & Hughes, 1994)
South Africa	Growth factors of small businesses in South Africa	(McPherson, 1996)
China	Main growth factors of the Chinese small businesses (finance and informal ties)	(Hussain, Scott, Harrison & Millman, 2010)
Central and Eastern Europe	Growth factors of small and medium-scale fast-growing enterprises in the region	(Matveev & Anastasov, 2010)
Slovenia	Networking in Slovenian fast-growing enterprises	(Bratkovic, Antoncic & DeNoble, 2012)
Taiwan	Financial Growth factors of enterprises in Taiwan	(Kiani, Chen & Madjd-Sadjadi, 2012)

*Table 2: Different factors for economic growth*

Subject of Research	Citation
Analyzed the correlation between size, age and growth rates of manufacturing enterprises	(Evans, 1987)
Compared the activities of ordinary and fast-growing enterprises with reasons for founding the businesses in correlation to growth opportunities	(Birley & Westhead, 1990)
Studied the process of establishing small businesses, their growth, and struggle for survival	(Arrighetti, 1994)
Analyzed the influence of money market availability on the ability of enterprises to grow rapidly	(Chittenden, Hall & Hutchinson, 1996)
Complex study of the dynamics of small businesses' distribution according to their size	(Cabral & Mata, 2003)
Study of the capabilities of small businesses to create new jobs	(Henrekson & Johansson, 2010)
Evaluated the interdependence of financial soundness and enterprises' growth abilities	(Arellano, Bai & Zhang, 2012)

(Yudanov, 2010, 2012) and (Dolgin, 2014) demonstrated the important role of ‘gazelle enterprises’ in developing the Russian economy. (Barkhatov, 2014) analyzed opportunities of medium-sized enterprises to solve contradictions and controversies typical of the present-day economy in Russia.

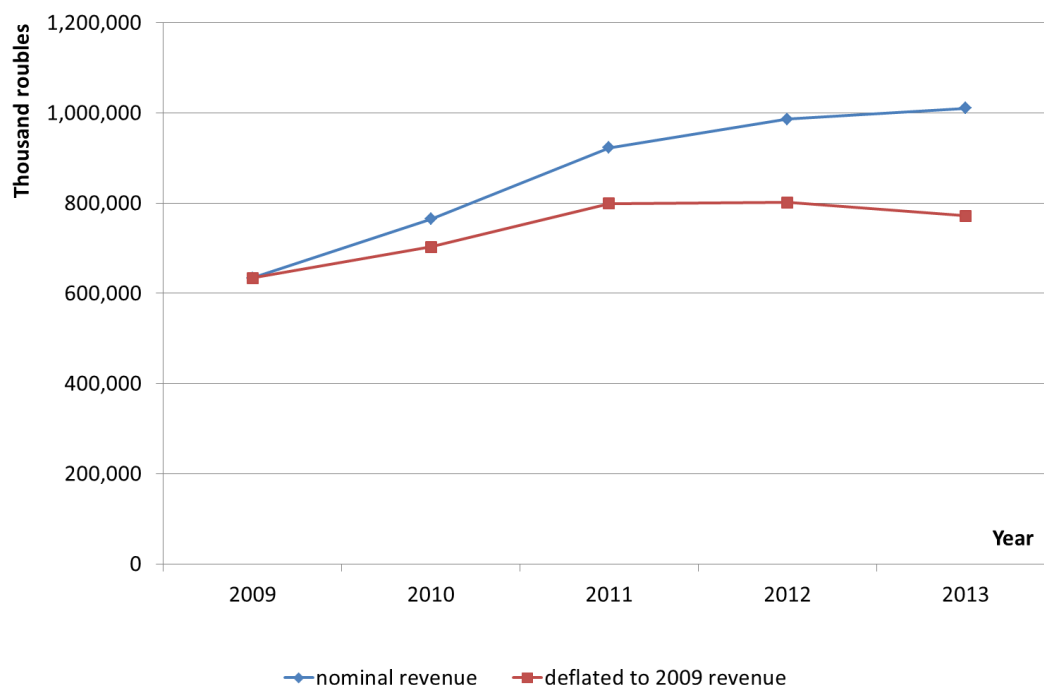
### 3. METEDODOLOGY AND DATA

In order to analyze fast-growing medium-sized enterprises, the authors used a business success conception as described earlier in (Barkhatov & Pletnev, 2014). This conception is based on viewing success as measuring an enterprise's vitality, which in turn manifests itself in the ability to grow and generate profit. To analyze success factors for Russian ‘gazelle enterprises’, the researchers consulted the FIRA PRO database (<http://pro.fira.ru>) containing financial statements

of more than 5 million Russian legal entities. As of July 2015 – the date when the analysis was carried out – the database contained data recorded only up until 2013. The time period selected for analysis was from 2009 to 2013, a period right after the economic crisis of 2008 when nearly all enterprises experienced a decrease in sales. The enterprises selected were privately-owned (state unitary enterprises and municipal unitary enterprises were excluded) and those considered to be middle-sized enterprises (i.e. with revenues from 400 million to 1 billion rubles per year in 2009) and which submitted financial statements from 2009 until 2013. As a result, 3,800 enterprises were selected. In addition, this study also calculated the added value using data on the value of material and depreciation costs. In other words, the enterprises in this study were those which survived the acute phase of the 2008 crisis and continued functioning as “ordinary” enterprises before going on to achieve different degrees of success.

#### 4. RESULTS

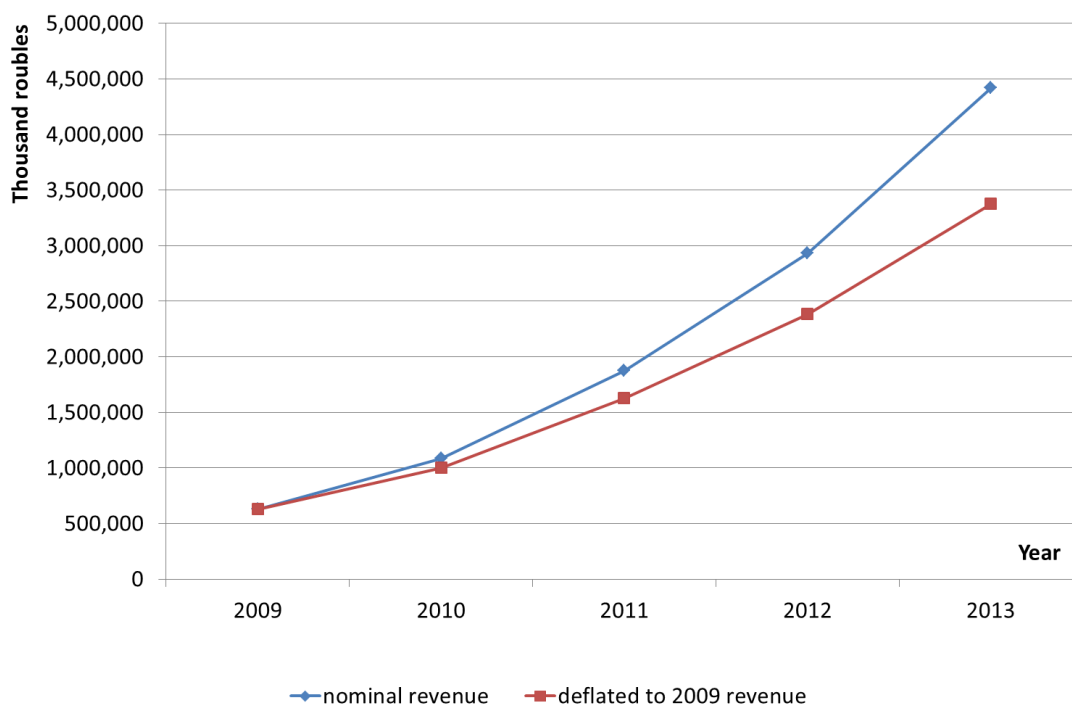
The average revenue of the selected enterprises in the period under study demonstrated a positive trend of increasing from 634 million rubles to 1010.8 million rubles; the average annual growth rate was 12.4%. This period was characterized by a slowdown in revenue growth (from 21% in 2010 and 2011 to 2% in 2013). It should be noted that the positive dynamics were traced for the nominal revenue, but taking into account inflation it is clear that overall revenues decreased in 2013 when calibrated to 2009 revenue. (When calculating the inflation rate, the data of the Russian Federal State Statistics Service were used. for the period from 2010 to 2013, it was 30.9%). Since we deal with nominal values, it is advisable to take into consideration the negative dynamics of deflated figures. Nevertheless, further calculations and conclusions are to be made with the nominal values. The share of added value could only be assessed until 2011; after this year, the data were not provided by the enterprises. In 2009 and 2011 the average value was mostly steady, amounting to 53 - 54%.



*Figure 1: The dynamics of nominal and deflated average revenue for a sample of all medium-sized enterprises in Russia (Conducted by the authors)*

The next step was choosing ‘gazelle enterprises’ from all the enterprises selected. The Birch criterion was used to identify them – every year the revenue must increase by at least 20%.

It should be noted that the observation period in this study was shorter than that recommended by Birch (only 4 years) mostly due to an absence of data. Nonetheless, the reduction in time can be rightly justified because of the dynamism and instability of the Russian economy. Of all the selected enterprises, 62 were identified as ‘gazelle enterprises’. For those businesses, the average revenue value was characterized by rapid growth, much greater than the minimum of 20% a year. In 2009, the average revenue value for ‘gazelle enterprises’ was 628 m. rubles whereas in 2010 it already exceeded 1 b. rubles; exponential growth was typical of the average revenue value. In 2013 it was 4.42 b. rubles. Thus, an “average” gazelle enterprise “jumped” beyond the boundaries of middle-sized business and moved into the category of large business. This happened already by 2010. It is also interesting that the revenue growth rate in 2010 and 2011 was the same for ‘gazelle enterprises’. It was by far more than in all the enterprises selected – 73%. In 2012, the growth rate experienced a deceleration of 56%, which continued in 2013 (51%). Figure 2 demonstrates the growth of those enterprises.



*Figure 2: Dynamics of nominal and deflated average revenue for ‘gazelle enterprises’  
(Conducted by authors)*

Among the 62 ‘gazelle enterprises’, 20 were registered before 1999 (29.9%), 28 (41.8%) from 1999 to 2005, and 14 (20.9%) from 2006 onward. In comparison with all of the selected enterprises in general, it becomes apparent that ‘gazelle enterprises’ enjoy an obvious “rejuvenation.” This indirectly confirms the hypothesis that an enterprise has a life cycle with a slowdown at the end, as studied by (Quinn & Cameron, 1983), (Adizes, 1989), (Shirokova & Serova, 2005). The ability for rapid growth inherent in the “old” enterprises is significantly lower than in the “young” ones. Nonetheless, there are quite a few “old” enterprises among ‘gazelle enterprises’; it means that the long lifetime of an enterprise is not an obstacle for it to obtain rapid growth. However, it is necessary to consider the interrelation between the age of an enterprise and its capability for rapid growth. First, for all the selected enterprises the typical pattern shows a direct interrelation between the year of its foundation and its average annual growth rate. So, for enterprises established in 1992, the average growth rate was 7.8%. For enterprises established in 1999 it was higher – 11.4%.

For enterprises established in 2005 it was 14.3%. Finally, for enterprises established in 2009, the average growth rate was a staggering 31.8%. Of course, in each case the variation of growth rate is significant; however, there is a statistically significant relationship between the year of an enterprise's foundation and its growth rate. It should also be noted that the average annual growth rate increases in “younger” enterprises. Local maximums in 1996, 1998 and 2002 are explained by the presence of a single gazelle enterprise with a very high growth rate, though this cannot be considered a typical phenomenon. High values for enterprises registered in 1991 prove that enterprises had potential for growth though being so-called “descendants” of Soviet enterprises which survived all the crises of the 90s and kept functioning until present day. A similar situation occurs with ‘gazelle enterprises’. The interrelation between the year of foundation and the average annual revenue growth rate is direct and statistically significant. Young enterprises are more active; they aim to growing rapidly and as a rule achieve it sooner. Thus, for all the selected enterprises, the average age was 14.3 years while for ‘gazelle enterprises’ it was 12.3 years. This research also addressed the ability of ‘gazelle enterprises’ to create added value and compared it with the values for all selected enterprises. To calculate the added value, the authors used the approach described earlier in (Pletnev, 2013). The average figures in the selected enterprises, without being divided by industry, show that ‘gazelle enterprises’ have a greater ability to create added value. If for all the selected enterprises the share of added value was 53% in 2009 and 54% in 2011, for ‘gazelle enterprises’ the corresponding values were much higher – 66% and 71%. It should also be noted that the share of added value in revenues for ‘gazelle enterprises’ increased in tandem with the enterprises’ growth. This means that while a gazelle enterprise is growing it is also improving its position in the value-adding chain. However, this dynamic is only characteristic of some aggregate-industries. We singled out those aggregate-industries in which ‘gazelle enterprises’ were found and also compared shares of added value (see Table 3).

*Table 3: Characteristics of “Ordinary” and Fast-growing Enterprises of Different Aggregate Industries (conducted by authors)*

Aggregate industry	Number of enterprises	Share of added value in revenues, %		Number of ‘gazelle enterprises’	Share of added value in revenues of ‘gazelle enterprises’, %		Growth of share of added value in revenues (2009-2011), %		Excess of the share of added value of ‘gazelle enterprises’ over the average in 2011, %
		2009	2011		2009	2011	In general	In ‘gazelle enterprises’	
Trade	1,062	66	71	24	79	86	5	7	15
Industrial production	683	40	38	8	41	22	-2	-19	-17
Food, fishing industry and agriculture	615	33	31	8	40	35	-2	-6	4
Construction and architecture	483	50	52	8	61	70	2	9	18
Services	357	67	71	4	78	92	5	14	20
Mining	157	68	70	4	52	57	2	5	-6
Transportation	144	60	63	2	81	100	2	19	30
Energy industry	109	52	44	2	93	98	-8	5	54
Consumer goods industry	49	43	47	2	31	27	6	-4	-20

From the aggregate-industries under study, the following had similar tendencies: Trade, Construction and Architecture, Services, and Transportation. All of those industries provide services or carry out different activities unrelated to the production of goods in any form. It can thus be concluded that ‘gazelle enterprises’ in those sectors are the most successful and promising. This is the way the post-industrial tendency manifests itself in medium-sized businesses functioning in the Russian economy. The manufacturing industries, however, exhibit an “anomaly”: the share of added value in revenues is reduced (Industrial Production, Food, Fishing Industry and Agriculture), and rapid growth is achieved by enterprises which have a smaller than average share of added value in revenues (Industrial Production, Food, Fishing Industry and Agriculture, Mining, Consumer Goods Industry). This may indicate that rapid growth is achieved by increased material costs or price reduction, which could eventually bring an enterprise to bankruptcy. To evaluate the success of fast-growing enterprises, this study compares the ability of “ordinary” enterprises and ‘gazelle enterprises’ to generate profit. To assess this ability, we used return on sales (ROS) calculated on net profit. The choice of this indicator is explained by the authors in (Pletnev & Nikolaeva, 2014) and is used in (Nikolaeva & Belova, 2014). The calculations showed that fast-growing enterprises have a much better ability to generate profit and they are more successful both in terms of capability for growth and in terms of profitability (see Table 4). In each of the periods under study, the net profit (on the average per enterprise) and return on sales in fast-growing enterprises were several times higher than the average figures in all of the selected enterprises.

*Table 4: Fast-growing enterprises’ Ability to Generate Profit (conducted by authors)*

Selection of enterprises	Average net profit per enterprise, mln. rub.				Average ROS calculated on net profit, %				
	2010	2011	2012	2013	2010	2011	2012	2013	Average in 2010-2013
All enterprises	29.97	29.44	39.23	28.25	3.9	3.2	4.0	2.8	3.4
Fast-growing enterprises	108.77	194.67	255.82	311.40	10.0	10.4	8.7	7.0	8.4

Moreover, among ‘gazelle enterprises’ there were only nine which made a loss (and only from 2010 to 2013). The remaining 53 (85.4%) were profitable in every period under study. And only two fast-growing enterprises (3.2%) throughout the entire period under study made a gross loss (i.e. could not break even). Among all the selected enterprises, the number of enterprises which made profit during the period under study is 2,428 (63.9%). 763 enterprises (20.1%) made a gross loss. It can be concluded that fast-growing medium-sized enterprises are more successful than “ordinary” medium-sized enterprises.

## 5. CONCLUSION

In this study, we provided general characteristics of fast-growing enterprises (gazelle enterprises) of medium-sized business in Russia, based on their financial statements for the years 2009-2013. The first thing that is immediately apparent is the fact that the number of fast-growing enterprises is extremely low – of the 3,800 enterprises selected for this study, only 62 of them satisfy the definition of a gazelle enterprise by the revenue criterion (about 1.6%). There are quite few independent production enterprises among the gazelles. It is a good thing that the production sector is represented to a large extent by agricultural enterprises (7 of 26). The success of fast-growing enterprises is possible not only in industries with fast return of capital (such as wholesaling and retailing) but also in production industries. It was discovered that young enterprises tend more to rapid growth: the number of enterprises registered after 2005 among the ‘gazelle enterprises’ increased almost twofold in comparison with all the selected

enterprises – from 11.5% to 20.9%. This conclusion supports the theory of I. Adizes (Adizes, 1989) and others about the dynamics of the lifecycle of enterprises. It seems rational that to make an enterprise grow rapidly, it is easier to invest money and effort in a new project (even if using the same facilities and specialists), than to try to vitalize an “old” enterprise. Even legal “rejuvenation” could be a condition for successful growth. Special attention should be paid to the results from the analysis of added value distribution in revenues of fast-growing enterprises when compared with all middle-sized businesses. If we take into consideration all the selected enterprises, the middle-sized businesses had 53% of added value in revenues in 2009, and by 2011 it had increased up to 54%. For fast-growing enterprises in 2009 the share of added value was significantly higher at 66%, increasing to 71% by 2011. For industries related to services, rapid growth is accompanied by a greater growth of added value in revenues (from 79% in 2009 up to 88% in 2011). In the construction industry, the dynamic is similar to that of the services sector – there was an increase from 61% to 70%. Fast-growing enterprises of production industries (excluding construction) are quite the opposite; they only achieved rapid growth by sacrificing their added value (its share in 2009 is 39% while in 2011 it is only 27%). It can be concluded that the success of fast-growing medium-sized enterprises in Russia is determined by the right choice of business specialty. The success of fast-growing enterprises has been proven to be much higher than that of the “ordinary” enterprises when evaluated by their ability to generate profit. In each of the periods under study, the margin on sales of ‘gazelle enterprises’ was 2-3 times higher and the average net profit per enterprise was 3-10 times higher. Thus, rapid growth is possible without sacrificing current profitability; and if an enterprise is able to reveal the secret of how to become a gazelle enterprise, then in the Russian economy the probability of success would likely be very high. The trick is to reveal this secret, which can be done with further research. The problems raised in this study can be subjects of research to be done in the following areas: (1) conducting multi-dimensional grouping of aggregate-industries in order to reveal regularities of achieving success by fast-growing enterprises in these sectors and in order to identify clusters of those industries; (2) proceeding with analyzing activities and development of fast-growing enterprises in 2014-2015, assessing their success in times of crisis; and (3) a thorough case study of selected fast-growing enterprises to uncover the individual factors of their success.

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## MONITORING EMPLOYEES COLLABORATION IN WORKING TEAMS – LEADER’S PERSPECTIVE

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### ABSTRACT

*Nowadays companies that aim at improving their efficiency, innovativeness and thus competitiveness have to focus on the issues of collaboration both inside and outside a firm. Collaboration becomes a strategic initiative for business entities focusing on the increase of productivity and cross-functional capability within their workforce. Smart companies make use of employees networks and their ability to work together. However, in order to take the advantages of employees collaboration within a company, in particular within working teams, managers have to monitor this collaboration. They can do it through implementing the organizational climate fostering employees cooperation, applying several tools dedicated to managing employees collaboration, rewarding employees collaboration outcomes as well as being sensitive to the problem of collaboration overload. The paper is an attempt to contribute to the research in the field of teamwork management, in particular by examining the problem of employees collaboration monitoring preventing collaboration overload. The paper addresses two following tasks. The first part of the paper provides an theoretical overview of the issues regarding employees collaboration in teams, collaborative leadership as well as the ways and tools for monitoring employees collaboration in teams. The second, empirical part of the paper, explores the problem of employee collaboration monitoring. particularly. The aim of the paper is to assess the scope and importance of employees collaboration monitoring within working teams in a company. In order to answer research questions and achieve the aim of the study the exploratory case study analysis is applied. Generally, the study proves the crucial role played by the monitoring employees collaboration by the leaders. In the conclusion the further research ideas arising from this one are presented.*

**Keywords:** *collaboration overload, employees collaboration in working teams, monitoring collaboration in working teams*

### 1. INTRODUCTION

Observing business reality leads to the reflection that too often a role of leader is associated with taking power over employees. It seems that in today’s highly networked, team-based business reality the role of leader should be rather taking power with employees working together. More and more, effective leadership is considered as the mixture of collaboration, listening, communicating, influencing and flexible adaptation, rather than command and control (De Meyer, 2011). Moreover, nowadays there is considerable agreement among writers and practitioners on the view that teamwork is significant in terms of generating firm’s results in the field of competitiveness and innovativeness. Applying teamwork companies are able to increase employees and firms’ productivity and come up with new products faster than the competitors. Collaboration and teamwork is perceived as one of the keys to organizational success. It has been noticed that over the past two decades, the time spent by people in collaborative activities at work has ballooned by over 50% (Cross, Rebele, Grant, 2016, p.77).

The aim of this paper is to assess the scope and importance of employees collaboration monitoring within working teams in a company. In order to answer research questions and achieve the aim of the study the exploratory case study analysis is applied. Generally, the study proves the crucial role played by the monitoring employees collaboration by the leaders. In the conclusion the further research ideas arising from this one are presented.

## **2. THE NATURE AND IMPORTANCE OF TEAMWORK**

When considering the issue of a team within an organization, it is very difficult to point out one clear definition. However, the literature review allows to outline some characteristics of a team. A team is a social group which members are tied by formal and informal relationships, do collective work aimed at accomplishing particular goals in order to obtain both material and non-material bonus. In contrast to a group, team has clear boundaries within a company. Secondly, team has its own values, structure and paths of interactions and members have different functions and positions in decision making process. Next important feature refers to the fact that in team members are motivated both by interpersonal relationships and material (financial) benefits (Kozusznik, 2011, pp. 102-103). As highlighted by Hill and Lineback, people perform better in a team while there is a strong mutual commitment to their joint work. This commitment creates compelling social and emotional bonds among members, who come to believe that ‘we’ will all succeed or fail together (Hill, Lineback, 2012, p. 16). This strong commitment is also called a sense of community. Taking this point of view, the aforesaid authors argue that leaders should highly focus on mutual sense of purpose that is felt by team members. A team which believes that it exists for a compelling reason. Such team’s members believe that their benefit is not the work they accomplish, but the benefits they deliver to the company. What is interesting, people involved in such team value the possibility to work together more than work promotion or even salary increase (Walas-Trębacz, 2002, p. 150). The second significant issue regarding high performance teams relates to tangible goals that are based on the sense of purpose felt by the team. Hill and Lineback argue that while these conditions are present, managers observe a transformation in their teams. Employees start to work at a higher level not because the leader requires it but because their colleagues expect it. Moreover, this is the moment when a group makes the change from group to team. Moreover, the aforementioned researchers claim that from this point a team starts to manage itself. The performance of team members is based on social and emotional bonds of coworkers and not the expectations of the leader. Thus, a leader instead of imposing and directing, should concentrate on suggesting and supporting. In turn, group members transform into a team members by freely committing themselves to a mutual purpose (Hill, Lineback, 2012, p. 16). On the other hand, Haas and Mortensen claim that in order to attain high performance of teams leaders must remember about the following issues. First of all, team members need a direction that energizes, orients, and engages its members. Such a direction is the foundation of high team performance. This issue is of particular importance in diversified teams as it is easy for team members from dissimilar backgrounds to hold different views of the team purpose. The second important issue refers to a strong team’s structure. This means that high-performing teams include employees with a balance of different skills, e.g. technical or and social ones. The next condition of obtaining high team performance refers to maintaining a reward system which reinforces good performance, an information system that provides access to the data needed for the work, and an educational system offering training, and securing the material resources necessary to do the job, such as funding and technological assistance. Finally, the last significant issue pointed out by Haas and Mortensen is developing a shared mindset among team members by fostering a common identity and understanding (Haas, Mortensen, 2016, p. 74). This refers to having common sets of core values among team members. Such values may concern learning (from each other), collaboration, sense of responsibility, ambition etc. Among important topics

regarding the factors influencing high team performance, there is also a necessity for underling the importance of communication. Teamwork involves the active discussing and collaboration of information and ideas, but with many points of view. Due to frequent communication, team members learn from each other, and discover new ways of thinking. The issue of communication is strongly related to the matter of relations between team members, their mutual trust as well as emotional support. As argued by Kroth, emotional support from co-workers helps employees accomplish their goals as it is needed to cope with feelings such as anxiety, worry, or inadequacy that might sidetrack goal pursuit intentions (Kroth, 2007, p. 15). A team is ripe to provide its members with emotional support, as it involves many individuals coworkers working together, either alongside each other or in constant communication. Thus leaders focused on promoting efficient team members collaboration should remember that according to the definition trust encompasses the emotional safety in relationships among employees. If there is high degree of trust between team members, they are eager to be open and frank with one another, sharing their knowledge and expertise (Isaksen, Lauer, Ekval, Britz, 2000-2001, p. 175). Moreover, the leaders need to consider that interpersonal trust grows up of a communication between people. Open and frank communication between team members stimulates the emergence of trust between them. In turn, co-workers count on each other for any kind of support, they are willing to share information and knowledge with their team mates. This is of significant importance both for teams' and organizations' outcomes. It has been proved that high level of trust among team members benefits in an increase of operations speed, creating positive employee attitudes, enabling transfer of knowledge and expertise, increase of employees' creativity, innovation, and loyalty as well as an increase in their motivation (Dirks, Ferrin, 2001, pp. 618-621). Aforesaid benefits result from the fact that while trusting each other, team members are willing to debate and discuss opposing opinions. Thus they are able to share a diversity of perspectives. However, in order to create such environment and climate, it is necessary to provide team members with a sense of security (Isaken et al. 2000-2001, pp. 173-175).

### **3. THE ROLE OF A LEADER IN FOSTERING COLLABORATION WITHIN WORKING TEAMS**

Having to bear in mind that teamwork and the ability to collaborate are so important nowadays, it is necessary to focus on leader's attributes and activities fostering team members effective collaboration. There is a considerable agreement among researchers on the fact that a leader who aims at stimulating his/her subordinates cooperation must be good collaborator himself/herself. Increasing interest in the meaning and importance of teamwork and employee collaboration led to appearing the idea of collaborative leadership, perceived today as a vital source of competitive advantage in business environment. Collaborative leadership means engaging collective intelligence to deliver results across the organization when ordinary mechanisms of control are absent. Collaborative leadership refers to using the power of influence rather than positional authority in order to engage and align employees and focus their teams. Good leaders stimulating their teams collaboration must be the drivers for the employee networks. Collaborative leadership requires that “one makes constantly the trade off between going it alone and working through others, in favor of the latter” (De Meyer, 2011, p. 38). The leaders taking such approach aim at creating the climate of trust, positive relationships, mutual respect and shared aspiration in which all employees can contribute to accomplish the collective goals (Hurley, 2016, p. 3). In other words, they build a culture of community, focusing on the value that refers team members' work toward common goals. Thus collaborative leaders focus on team members commitment to the whole by moving from a “concern for ‘me’ to a passion for ‘we’ (Hurley, 2016, p. 6). An effective collaborative leader constantly monitor what is going on with the peers. Thus, it involves effective and honest communication, based on mutual trust.

As highlighted by Ibarra and Hansen, collaborative leaders need to focus on creating skills in four areas. First of all, they have to play the role of “connectors”. This phrase regards leader’s ability to link people, ideas and resources that wouldn’t bump into one another without them. In other words, in business world, “connectors” are critical facilitators of collaboration and development. Secondly, as it is known that diverse teams produce better results, effective leaders should be able to bring people from different backgrounds, disciplines, generations etc. in order to leverage all they have to offer. This ability is called ‘engaging talent at the periphery’. The next issue refers to the fact that collaborative leaders must lead themselves to create more collaborative cultures in their organizations. In other words, they should set the tone by being active and good collaborators themselves. The fourth of aforementioned areas of collaborative leaders’ skills regard showing a strong hand and keeping teams from getting mired in debate. This means that effective collaborative leaders assume a strong role influencing and directing their teams (Ibarra, Hansen, 2011, pp. 68-74). As highlighted by de Meyer, an effective leader fostering team collaboration is able to influence and convince his/her peers without falling into the trap of becoming manipulative (de Meyer, 2011, p. 38). It is also argued that the leaders who are able to facilitate employee collaboration build “authentic relationships among peers in which the shadow side of hierarchy has no place” (Hurley, 2016, p. 6). In the teams managed by collaborative leaders mutual empowerment replaces top-down control and growing trust creates the field for effective collaboration. This is related with creating so called positive relationships at work. According to the relevant literature, positive relationships among employees are said to be antecedents of several positive results for both individuals and organizations. Considering a team perspective, positive relationships at work create a feeling of psychological safety and trust, contributing to greater level of learning (Carmeli, Brueller, Dutton, 2009, pp. 692-724). Moreover, it is said that co-workers who create positive relations with one another are more willing to invest their energy in helping others. Having to bear in mind that developing a climate fostering employee collaboration is highly dependent on mutual trust, mutual support and knowledge sharing, collaborative leaders should focus the issues concerning communication. Collaborative leaders are aware of their responsibility for communicating effectively. Thus they consciously use intentional conversation to achieve key ends. Instead of telling people what to do and directing, collaborative leaders promote learning, co-creation and open communication for collective achievement. Their role refers to creating a safe space for dialogue and collective attention in order to encourage team members to participate in common work and group benefits (Hurley, 2016, p. 7).

#### **4. COLLABORATION OVERLOAD AND THE WAYS TO MONITOR EMPLOYEES COLLABORATION IN WORKING TEAMS**

Among pertinent issues regarding collaboration within working teams, there is a necessity for underling the importance of the problem of collaboration overload which can be defined as the point when employees spend more time working on ad hoc requests from their co-workers than accomplishing their own tasks and working towards their own goals. Referring to this issue, Cross, Rebele and Gray claim that much too often high-performing employees are overloaded by collaboration with their co-workers. The aforementioned authors have investigated over 300 companies and found out that the distribution of collaborative work very often is extremely lopsided. As highlighted by Cross et al., in many of studied organizations 20% to 35% of value-added collaborations come from only 3% to 5% of employees. Workers who become known for being capable as well as willing to help others, are drawn into several projects as key elements of working teams. Due to their giving mindsets and the desire to help others, such employees contribute beyond the scope of their roles and drive team performance more than all the other team members combined. However, the problem is that with time those effective and helpful employees become company’s bottlenecks.

That means work does not progress until they have weighed in. Moreover, the research findings show that they are so overtaxed that they are no longer personally effective. In addition, Cross et al. have found out that more often than not the volume and diversity of work that such collaborative employees do in order to benefit others goes unnoticed. It results from the fact that the requests for help are coming from other units, different offices, etc. (Cross, Rebele, Gray, 2016, p. 78). In turn, the employees who are the highest in demand by their colleagues to cooperate, with time become those who are the most likely to leave the company and take their knowledge as well as network with them (Chodorek, 2016, 171). As highlighted by the relevant literature, collaboration overload may erode performance and stop innovation. It damages employees productivity, but what is even worse, it also damages their health (Dewar, Keller, Lavoie, Weiss, 2009, p. 3). Moreover, while taking organization's perspective, collaboration overload may imply in high costs resulting from losing valuable employees. This problem has been studied by Ballinger, Craig, Cross and Gray. The aforementioned authors point out that they “encountered numerous employees who had developed a reputation for being knowledgeable and reliable, which led many colleagues to turn to them for expertise, information, or assistance. Unless steps were taken to offset these constant demands, these employees' performance often declined as network demands increased. When such high levels of demands persisted over time, employees often burned out and left, thus creating a significant gap in the network” (Ballinger et al., 2011, p. 7). The researchers argue also that it is not possible to replace a longtime employee without disrupting company's network of formal and informal relationships. It takes time for other employees to understand a new colleague real expertise and even longer to develop trust in this person's intentions and capabilities. This in turn generates costs resulting from team's productivity decrease (Borgatti, Cross, 2003; pp. 432-445; Ballinger et al., 2011, p. 5). Regrettably, traditional managerial methods like process maps, responsibility matrices, formal organizational structures etc. do not identify the causes of collaborative overload (Cross, Gray, 2013, p. 2). So taking the problem of collaboration overload into account, managers have to learn to better manage employee collaboration by understanding how information flows across teams, mapping the demand and supply for it, eliminating or redistributing work as well as encouraging workers to collaborate more efficiently. Thus, leaders managing teams first of all should be able to assess where the collaboration is necessary and where it is not. In their conceptual framework, Cross, Rebele and Grant point out that to manage the demand for employee collaboration more effectively, managers need to notice and distinguish three types of employees' collaborative resources. Collaborative resources are understood as those that individual employees invest in order to create value at work. Cross et al. distinguish three categories of such resources: informational, social and personal. Employee informational resources refer to the knowledge and skills that can be recorded or passed on to others. Social employee resources include person's awareness, access as well as position in a network that can be used to help co-workers to better cooperate with one another. Finally, personal employee resources involve person's time and energy. What is of significant importance, not all of aforesaid collaborative resources are equally efficient. Managers need to remember that informational resources may be shared. Moreover, an employee who shares knowledge and expertise at same time retains it for his/her own use. However, if we consider person's time and energy, they are finite resources. This means that each request to employee participation in any project leaves less available for that person's own work (Cross et al. 2016, p. 78). In order to increase the efficiency of employees collaboration, first of all managers need to understand the existing supply and demand for collaboration. They must learn to recognize, promote and efficiently distribute the kinds of collaborative work. In other words, leaders have to manage the structure of collaboration within a team or organization. Lack of the process, templates and structure for knowledge sharing, cooperating employees need help from others more often.

If there is lack of such management, the most collaborative employees as well as top talents may bear the costs of too much demand for too little supply (Cross et al. 2016, p. 84). There are several methods and tools that enable to do this. The managers may conduct network analysis, introduce peer recognition programs and value-added performance metrics. The most common tools used in practice include: employee surveys, electronic communication tracking, company internal system like 360-degree feedback or CRM. Such tools may provide valuable data concerning the volume, type, origin and destinations of requests for help. This data should be used to redistribute the work within employee teams. When considering the issue of monitoring employee collaboration in order to avoid collaboration overload, Cross and Gray claim that rebalancing collaboration demands for overloaded individuals can be achieved by redefining their roles, modifying their behaviors and developing alternative sources of information (Cross, Gray, 2013, p. 9). In particular, the issue of identifying and modifying employees' behavior seems to be crucial. In order to do it efficiently, managers need first to identify and secondly, replicate the behaviors of efficient collaborators within a team. The most efficient collaborators are those who provide the greatest value to others in the team while consuming the least amount of time. On the other hand, managers should identify and then remove the routine decisions which involve too many people for too long. Cross and Gray in their work titled “Where Has the Time Gone? Addressing Collaboration Overload in a Networked Economy” provide 17 tips (distinguishing structural and behavioral ones) for team leaders referring to reducing collaboration overload (Cross, Gray, 2013, p. 10). Additionally, applying Organizational Network Analysis (ONA) enables to see the problems related to efficiency among cooperating employees by identifying overload points in a network. ONA is a method used for analyzing patterns of interpersonal interactions in order to understand the structure of employee collaboration within a team or organization. It is a mighty tool allowing to discover decisions which impose high collaborative costs. According to several research, the less efficient employees consume two to five times as much of others' time per interaction than employees who are most efficient. Moreover, the research proves that 3% to 5% of employees in a company frequently account for 20% to 35% of the value-added collaborations (Schweer, Assimakopoulos, Cross, Thomas, 2011, pp. 35-42). Thus, ONA through identifying such issues, enables to propose improvements in employees collaboration within a team or organization. ONA facilitates shifting several decisions to employees who are less consumed with existing collaboration or to embed a decision in a procedure while seeing which employees are typically consulted or involved in the decision (Cross, Gray, 2013, p. 13). ONA also helps managers understand the relationships in informal employee networks which foster or impede team collaboration. It also enables leader to move beyond valuing individual worker's contribution in a work setting to accounting for the way in which this employee makes others more successful through collaboration (Ballinger et al., 2011, p. 5). As highlighted by Ballinger et al., conducting ONA also gives leader a way to pinpoint the situations in which targeted interventions may preserve relationships and protect a team from productivity decrease. Thus ONA is a managerial tool that can be applied in order to identify the employees whose loss could highly disrupt the organization. This means that leader should use ONA first to identify valuable employees and then to focus on retention strategies on high value employees within collaborating teams (Ballinger et al., 2011, p. 11).

## **5. THE METHOD OF THE STUDY**

The empirical contribution of the paper concerns the case of a company operating in the market of financial services in Poland (the company did not agree to present its name). Thus, the research method applied to achieve the aim of the paper is the single case study analysis. In line with relevant literature, the major advantage of the case study method is using empirical demonstration from real organizations in order to contribute to the knowledge in the field



(Myers, 2010). Moreover, as observed by the leading researchers in the field, the case study method has a great potential to study the issue of managing employee collaboration (Schweer et al., 2011, pp. 35-42, Cross, Gray, 2013, pp. 1-17; Cross et al., 2016, pp. 77-84). In order to achieve the aim of the paper, the following study questions have been addressed:

1. Are the leaders aware of existing different types of collaborative resources? Do the leaders evaluate employees resources (personal, informational and social) needed for collaboration? How do they evaluate these resources?
2. How do the leaders monitor collaboration and its outcomes within their teams? What kind of methods and tools do they apply? How does it contribute to team's results?
3. Do the leaders recognize the problem of collaboration overload? What kind of methods and tools do they apply to identify overloaded employees?

The analyses were carried out on the basis of original source materials collected in the investigated company. The study used detail in-depth personal interviews with teams' leaders. There were two managers who contributed with interviews including: the chief of Debt Collection Department, leading the team of nine employees and the chief of Contact Centre of the company, leading the team consisting of twelve employees. Most of the employees in both analyzed teams have been working in the company over five years so they have an extensive experience in collaborating with one another. Structured interviews with teams' leaders were focused on three issues: identifying and evaluation of employees collaboration resources, recognizing the problem of collaboration overload and the ways of monitoring collaboration within a team in order to prevent collaboration overload and increase team outcomes.

## 6. RESEARCH FINDINGS

Posing the first research question we wanted to find out leaders' awareness related to different categories of collaborative resources. The findings from the interviews with managers of both teams proved that they understand the existence of different types of collaborative resources. However, the importance of these three types, perceived from leader's perspective seem to differ. The manager of the first team (Debt Collection Department) as the most important has pointed out informational and personal collaborative resources. On the other hand, the leader of the second team (Contact Centre) definitely perceives social resources as the most important for the team collaboration. While considering the problem of evaluating team members' collaborative resources, conducted interviews showed that the leaders do it rather intuitively. They observe employees, communicate via e-mails, talk and on the base of such activities they assess team members' potential in terms of personal, social and informational collaborative resources. Addressing the second question we referred to the importance of managers' knowledge in the field of methods and tools enabling employees' collaboration monitoring. As said in the theoretical part of the paper, there are several tools that might be applied in this field. On the base of our research findings we assume that the company as a whole does not implement any standard methods to monitor effective employees collaboration. Our assumption results from the fact that the leader of the Debt Collection Department admitted that he does not monitor his team members' collaboration. He says that from time to time he receives a copy of an e-mail sent from one employee to another and this is his "source of information" about co-workers collaboration. The meetings of the whole team are arranged from time to time, while it is necessary. Such lack of frequent formal exchange of information among team members inhibits communication and thus trust that grows up of it. Moreover, Debt Collection Department leader's office is located quite far away from other team members' offices so in natural way they communicate rarely. As far as collaboration outcomes are concerned, Debt Collection Department team every quarter is obliged to accomplish a specified plan in order to get a bonus. The whole team is evaluated for its result (measured in points).

The leader of Debt Collection Department does not evaluate individual team members input into the common outcome, although he admits that some persons are more engaged than others. What is interesting, the leader of Contact Center team is rather advanced in applying several tools to monitor the collaboration within his team. She declares systematic use of electronic communication tracking and 360-degree feedback system. In her opinion, 360-degree feedback system is very useful in monitoring not only team members collaboration but also in assessing their satisfaction from work and the changes of climate in the team. The whole team has regular meetings – every Monday at 9.00 am. They meet in order to discuss contemporary problems and issues as well as talk the common team plans over. The leader of this team emphasizes also eliminating the barriers in team communication. In order to do this she leaves the door to her office open (although the whole office is made of glass) and encourages her team members to communicate frequently every day. She highlights that employees often come to her with their problems so she believes they trust her. In regard to collaboration outcomes monitoring, the leader of Contact Center uses much more sophisticated system. In this department both common team's and individual results are measured and evaluated. The team as a whole has to accomplish particular goals. The manager distinguishes three categories of them: quality goals, efficiency goals and sale goals. Apart from this, each team member has his/her own individual goal card (IGC). While evaluating individual employees, the manager analyses individual results and collaborative results of the whole team. This approach seems to be much more efficient while focusing on the issue related to our third research question, concerning the recognition of the collaboration overload problem. The diagnosis of the teams outcomes over last three years proves that Contact Center obtains much better results from year to year. The use of the tools dedicated for managing collaboration and the leadership focused on stimulating effective cooperation bring the desired outcomes. What is of particular interest, the leader of this team admits that she allows the decrease of individuals results in case of employees who are the most valuable collaborators accelerating the increase of whole team results. Unfortunately, in Debt Collection Department the situation is a bit different. Quite poor management of team members collaboration and relying mostly on team self-management lead to constant level of the team outcomes. Raising the last research question we consulted an issue of high impact that collaboration overload has on employees satisfaction, engagement and finally on both employee and team productivity. The conducted interviews proved that using professional tools to monitor employees collaboration enables to notice the workers who are potentially overloaded by cooperating with others. In case of Contact Center team, where different tools to monitor collaboration are applied, the leader is able to point out employees (two persons) who the drivers for the whole team efficiency. The manager of Contact Center notices that sometimes individual results of these people are lower than expected while observing their engagement. She declares that he is aware of the need to monitor the supply and demand for collaboration within the team. In order to overcome the problem he openly communicates such situations to other team members, focusing on increasing the demand for help from overloaded employees. The summary of the conducted analysis concerning monitoring teams' collaboration and its influence on the outcomes generated by them is presented in Table 1.

*Table 1. Collaboration monitoring versus teams' outcomes in the studied company (own elaboration)*

	Scope of collaboration monitoring	Evaluating teams results	Evaluating individuals results	Team outcomes over time
Team 1 (Debt Collection Dep.)	+	+++	+	++
Team 2 (Contact Center)	++++	+++	+++	++++

## 7. CONCLUSION

Summing up, the study examined the scope and importance of employees collaboration monitoring within working two teams in a chosen enterprise. The conducted analysis allowed to answer the research questions that have been addressed. The interviewed managers are aware of different types of employees' collaborative resources and they try to evaluate them. However, they do it by intuition. Research findings presented in the paper indicate that in the studied company there is no standardized system of monitoring employee collaboration and its outcomes within teams. The practices applied in the two analyzed teams in the field of monitoring co-workers collaboration and their outcomes (both on individual and team level) differ remarkably. These differences result from different leaders' attitudes and so the tools used by them. In particular we have been interested in studying how do the methods of monitor collaboration influence team's results. The study offers an empirical evidence that frequent and intentional use of the methods and tools intended for keeping track of employees collaboration pays off in longer period. The leader of the analyzed team that benefits from regular collaboration monitoring uses electronic communication tracking, 360-degree feedback system and double (individual and team) goal measurement system. This brings the knowledge without which it is not possible to understand and manage the demand and supply for employee collaboration, eliminating collaboration overload. The research project presented in the paper and its results have their limitations. First of all, the findings are derived from data collected through interviews conducted within the single case study of the company operating in financial service sector. We are aware that any attempts to generalize on the basis of the single case study are challenging while pattern matching with theoretical assumptions and explanation building become very difficult. Moreover, we are aware the interviewed leaders could express only their general opinions while the problem of effective employees collaboration is full of nuances and differ in case of each team in a company. Thus, the results are concerned as the contribution to further analyses, also conducted among employees (not managers). The presented study inspires us for further in-depth investigations, with a use of free-form interview, participatory observation or focus group interviews with the employees.

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## REVISION OF THE POSTED WORKERS DIRECTIVE - IS THERE EQUALITY OF OPPORTUNITY FOR POSTED WORKERS?

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### ABSTRACT

*Although posted workers represent only 0.7% of total EU employment, the posting of workers supports the cross-border provision of services across the Internal Market, particularly in the construction and some personal and business services sectors. Directive 96/71/EC (hereinafter: Posted Workers Directive) within the EU law aimed to provide a clear framework to guarantee fair competition and respect for the posted workers' rights so that both businesses and workers can take full advantage of the internal market opportunities. However, no society is free from injustice as we can see in example of posted workers who receive different wage for the same job as workers in European Union host country where they temporarily provide services for their employers. This shows that issue of inequality regarding labour rights is indeed a universal and permanently evolving phenomenon that could be analysed from philosophical and legal perspective. From philosophical perspective, fair equality of opportunity requires that social positions, such as jobs, be formally open to each individual. In other words, each individual should have a fair chance to attain these positions. Nevertheless, it is obvious that if every person and job were the same, wage levels other additional benefits that a worker receives for work would be uniform. However, this is not the case of Posted Workers Directive where posted workers wage differentials are result of inequality of wage. If we think of a wage as compensation for a worker, i.e., for the loss of leisure time, it would be just that same loss of leisure time should require equal compensation as well as the cost of separation from the family, staying in an unknown environment, and the inability to directly influence their situation. In the light of Rawlsian principles of justice authors will analyse the proposal for the change of the Posted Workers Directive and some aspects of controversies that have been raised between European Union Member States.*

**Keywords:** Directive 96/71/EC, Directive 2014/67/EU, Equality, EU Internal Market, Posted Workers

*“In a Union of equals, there can be no second class workers. Workers should earn the same pay for the same work in the same place. This is why the Commission proposed new rules on posting of workers.”*

*The President Juncker in his State of the Union on 13 September 2017*

### 1. INTRODUCTION

Fair equality of opportunity requires that social positions, such as jobs, be formally open to each individual. In other words, each individual should have a fair chance to attain these positions. Besides obtaining positions, workers should have equal rights for equal work such as equal wages and other additional benefits that a worker receives for work. Principles of distributive justice require that if every person and job were the same, distribution of wage and benefits should be uniform. Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of

services (hereinafter: Posted Workers Directive) and the Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 on the enforcement of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services and amending Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System (hereinafter: IMI Regulation) should be compatible with an idea that the individuals in the same workplace should have equal labour rights (e.g. equal pay for equal right) (Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, OJ L 018, 21.01.1997, pp. 1–6.; OJ L 159, 28.5.2014, Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 on the enforcement of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services and amending Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System pp. 11–31). However, no society is free from bypassing principles of justice and equality. The best example we can see in the case of posted workers who receive different wage for the same job as workers in host EU country. If we think of a wage as compensation for a worker, i.e., for the loss of leisure time, it would be just that same loss of leisure time should require same compensation as well as the cost of separation from the family, staying in an unknown environment, and the inability to directly influence their situation. In order to overcome problems of justice and equality within posted workers regulatory framework, the proposal for the revision of the Posted Workers Directive was issued (Proposal for a Directive of the European Parliament and of the Council amending Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, Strasbourg, 8.3.2016 COM(2016) 128 final 2016/0070 (COD)). Beside the problem with equality of wage, the proposal focuses on other equality issues such as working rights, social security system etc. The adoption of revision of the Posted Workers Directive raised controversies between European Union (hereinafter: EU) Member States and showed their differences regarding notions of justice and equality in labour rights. In the article, authors will analyse the proposal for the change of the Posted Workers Directive in the light of principles of justice and equality from philosophical and legal aspects and its implication on free labour market. The article is divided into several sections. In the first section, the authors will discuss on philosophical notions of principles of justice and its importance for solving equality problems within posted workers market. Second section, is reserved for doctrinal discussion regarding the proposal for the change of the Posted Workers Directive. The special attention will be given to the controversies that were raised regarding the adoption of revision of the Posted Workers Directive.

## **2. PRINCIPLES OF JUSTICE AND EQUAL DISTRIBUTION OF LABOUR RIGHTS IN THE CASE OF POSTED WORKERS**

The European Community (hereinafter: EC) was established to promote free trade and a free labour market among its Member States and to create a unified economic and social policy (Crovich, 1992, p. 477). Equal pay for work of equal value is a fundamental principle in European Union (hereinafter: EU) law and in the European Economic Area (hereinafter: EEA) Agreement (Holst, 2012, p. 1). Therefore, within EU we are committed to socially just society where all people have equal rights and equal opportunities to realize their potential and participate equally in all aspects of social, political, cultural and economic life. However, European policy regarding posting workers has become symbol of the social and economic inequality. The reason for inequality lies within the regulatory framework which allows companies to post their workers temporarily to a host EU country without abiding them by local labour laws. The proposal of revision of the Posted Workers Directive legally entitled posted workers to a range of core working rights.

However, as they remain employed by the sending country, workers also remain subject to the laws of posting country. Consequentially, phenomenon of posting between Member States become form of social dumping as workers from countries with more advantageous regulations for companies deliver a service in less advantageous countries (Richert, 2017). This concept in legal doctrine usually refers to alleged unfair advantage gained due to differences in social protection, social regulations and social conditions between Member States (Richert, 2017). Therefore, it is necessary to discuss what principles of justice could help us to understand Posted Workers Directive controversy (Holst, 2012, p. 10). Principles of justice, according to J. Rawls, require that the basic structure of a society is organized in way that all social and economic inequalities maximize the lifetime expectations of the society's least advantaged members (Schaller, 1998, p. 368; Rawls, 1971, pp. 62, 93). In term of posted workers, the society's least advantaged members would be workers who are subject of unequal distribution of rights for same work in comparison to domicile workers in the host country. If we observe labour rights (e.g. right to wage) as distributive shares of primary goods (e.g. income) influenced by the social and economic position of workers, distribution of those rights in case of posted workers is arbitral (Rawls, 1971, p. 72, 73). To mitigate the arbitrary effects, according to Rawls, we should find principle that recognize the social contingencies (Rawls, 1971, p. 74). This principle should be based on notion that if there are social or economic inequalities, society need to make sure that all citizens enjoy equality of opportunity in the process of distribution of primary goods (Rawls, 1971, p. 74). Rawls consider that “social and economic inequalities are to be arranged so that they are both to the greatest benefit of the least advantaged (the difference principle) and attached to offices and positions open to all under conditions of fair equality of opportunity” (Rawls, 1971, p. 303). The principle highlights Rawlsian intuitive idea that the society's needs to make sure that every citizen enjoys equal opportunities in the life process by which come to achieve and avoid the unequally rewarded positions, such as work positions. One can question whether rational citizens would choose the Rawlsian principle. It might be more likely that citizens would choose a principle that would support a maximum life benefits for them, because there is no specific reason for someone to expect that he will actually end up as being the worst-off. However, the Rawls claims that citizens would advocate the maximum opportunity for equal distribution of primary goods only if they are not familiar with their position in society at the time of making distributive choices (Rawls, 1971, pp. 18-20). According to the Rawlsian principle, equal labour rights for posted workers are a fair way to distribute fruits of their work, as everyone should be entitled to the full value of whatever they produce. Therefore, we may say that it is unjust that economic and social differences of posted workers lead to inequality of opportunity regarding distributive shares of work fruits as domicile workers in host country. To departure from conception of inequality Posted Workers Directive has to be based on Rawlsian principle, which would help to establish and secure the more attractive prospects of those less fortunate, in our case posted workers, and establish a fair system of cooperation between Member States.

### **3. DEVELOPMENT OF REGULATORY FRAMEWORK FOR POSTED WORKERS**

The legal basis for the posting worker rights is regulated by the provisions of Posted Workers Directive which essentially determines the rights of employees to work in another Member State. Posted Workers Directive regulates different possibilities for posting such as: the direct provision of services by company under the service contract, posting in the context of an establishment or company belonging to the same group (intra-group posting) and posting through hiring out a worker through a temporary work agency in another Member State. Beside that it sets out the EU regulatory framework to establish a balance between the promoting and facilitating the cross-border provision of services, providing protection to posted workers and ensuring a level-playing field between foreign and local competitors (Explanatory

Memorandum, European Commission Proposal for a Directive of the European Parliament and of the Council amending Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, COM (2016) 128 final, Strasbourg, 8.3.2016). Posted Workers Directive was established with the idea of guarantee the rights of posted workers within the territory where the work was provided (Hatzopoulos, 2010). Therefore, application of Directive's main terms and conditions of employment, such as the maximum work periods and minimum rest periods, the minimum rates of pay, including overtime rates etc., are mandatory for the host Member State. Provisions regarding main terms and conditions of employment are applicable to all professions and industries when they are laid down by the law regulation or administrative provision of the host Member State. Since in some of the Member States these provisions are not laid down by the law, regulation or administrative provisions, but by the collective agreements or arbitration awards, they are applicable at least in the construction sector, while Member States have right to apply these conditions in other sectors too (Dumančić, 2016). The Posted Workers Directive represent the exemption of the free movement of workers rules guaranteed by the Article 45 of the Consolidated version of the Treaty on the Functioning of the European Union (hereinafter: TFEU) and it makes part of the freedom to provide services guaranteed by the Article 56 of the TFEU (Horak, Dumančić, 2011; The Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47–390). Article 45 of the TFEU proclaims that the freedom of movement for workers should be secured within the EU without any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment. Moreover, the freedom of movement should entail the right, subject to limitations justified on grounds of public policy, public security or public health: (a) to accept offers of employment actually made; (b) to move freely within the territory of Member States for this purpose; (c) to stay in a Member State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action; and (d) to remain in the territory of a Member State after having been employed in that State (Dumančić, 2016). These rules are applicable to workers that come to another Member State to work by their own initiative. In that case workers rely on the same remedies against breaches of their rights, whether through EU membership or another type of collective representation, individual action or going to court (Cremers, 2016, p.3). As we may notice the free movement of workers rely on the application of regulations in the Member State where the work is performed (*»lex loci labori«*). However, posted workers represent the exception of these rules as they are sent by their employer to another Member State to provide service for him. The idea behind posting of workers is that it is not the workers will to go abroad, but they are send by their employer to provide services and after accomplishing their tasks to return to their Member State (Dumančić, 2016). Therefore, free movement of the posted workers is considered as a part of the free movement of services that companies offer in another Member State by temporary sending their workers to supply those services within the free movement services rules (Proposal for the revision of the Posted Workers Directive, p. 2). Such interpretation could offer an explanation why during the posting period labour and social rights of posted workers are regulated by rules of home state regulations instead of the host state rules (Cremers, 2016, p. 4).

#### **4. THE NEED FOR CHANGE**

The Posted Workers Directive caused a number of debates and was often criticized as it opened the space for domination of economic reasoning and free movement rules over the social policy, labour standards and equal treatment of workers. In this sense the Posted Workers Directive showed that the priority was given to competitiveness and free trade rules (Cremers, 2016, p.



3). The main controversy regarding equality of workers was noticed when the companies started to use the possibility to post workers from Member States with lower social security rates to Member States with higher security rates to make their workers cheaper. According to the rules on freedom to provide services and freedom of establishment for companies which are guaranteed by the Articles 49 and 56 TFEU and confirmed by the practice of the Court of Justice of the European Union, it is on companies to decide from where they will conduct their business. In other words, it is up to companies if they want to use the workforce from the countries that have lower social security and other rates (Horak, Dumančić, Šafranko 2012). In such situations, the rules on free movement are not transparent and they are in conflict with social security legislation. Therefore, to make posted workers rules more transparent the revision of the Posted Workers Directive was launched and the final adoption of the directive is expected at a later stage when the legislation will be voted in the Parliament (<http://www.consilium.europa.eu/en/policies/labour-mobility/posting-workers/>). The revision focuses on issues of the distributive principle that should lead to the equal and fairly treatment for all workers in EU with no differences between local and posted workers if they are doing the same job at the same place. More specifically, the revision of Posted Workers Directive aims at ensuring fair wages and a level playing field between posting and local companies in the host country whilst maintaining the principle of free movement of services. Further, revision of Posted Workers Directive also propose that remuneration for work applies from the first day of posting, so that posted workers will benefit from the same rules on remuneration as local workers of the host Member States. The revision also accepts the concept of long-term posting which allows that workers are posted for the period longer than 12 month with the possibility of a 6 months extension. In case of long-term posting, the posted workers will be the subjects to nearly all aspects of the labour law of the host country. In addition, the novelty is that collective agreements can be applied to posted workers not only in the construction sector, but also in all sectors and branches. Regarding the temporary work agencies they are to guarantee to posted workers the same terms and conditions that apply to temporary workers hired in the Member State where the work is carried out (<http://www.consilium.europa.eu/en/policies/labour-mobility/posting-workers/>). Once the above proposed rules enter in to the force, they will approximate legal status of posted workers and change conception that posted workers are »cheap« labour force (Cremers, 2016, p.8). Therefore, the revision of the Posted Workers Directive indicate that Europe's structural labour market is turning to “fairness” and “equality” rather than competition and liberalisation (<https://www.ft.com/content/6ed52842-b89b-11e7-9bfb-4a9c83ffa852>).

## 5. CONCLUSION

A just society cannot be based on norms that systematically disrespect certain categories of people by marginalizing their experiences and contributions. Commitment to socially just society where all people have equal rights and equal opportunities to realize their potential and participate equally in all aspects of economic life is putting emphasis on principle of distributive justice. According to principle of distributive justice, each person would have a right to the full value of his work. If we accept distributive principle, society would become be a fair system of cooperation based on notion that “social and economic inequalities should be arranged so that they are both to the greatest benefit of the least advantaged (the difference principle)” (Rawls, 1971, p. 303). The issue of posted workers has always proved a controversial one from the point of principle of distributive justice, as it was hard to find the right balance between value of someone's work and interest of companies or Member States. The last proposal for the revision of the Posted Workers Directive successfully introduced the rule on the equal pay for equal work based on the idea that the »employee who is sent by his employer to carry out a service in another Member State for a temporary period« should have the same salary as the employee

from that state. (Dumančić, 2016). Therefore, we hope that after a long period of negotiation, the social dialogue will be achieved and equality of opportunity for posted workers will win the battle. However, the time will show what impacts principle of distributive justice will further have on the Member States labour market.

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## DAMAGES CLAIMS FOR THE INFRINGEMENT OF COMPETITION LAW IN THE EUROPEAN UNION AND CROATIA

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### ABSTRACT

*Breaches of competition law have negative effects on the relevant market as well as on the participants of the affected market. Protection of the market and competition is provided through the public enforcement where competent authorities investigate and sanction violators. On the other hand, injured participants, individuals or undertakings, can obtain civil law remedies in private proceedings, such as nullity of a contractual obligation, injunction, or an award of damages. To obtain damages award injured person must prove a breach of competition law provision, sustained harm, and a causal relationship between the harm and an infringement of competition law provision. Although the compensation for injured represents the first and the main goal of private enforcement, the other role could be observed through the deterrence effect on future violators of competition law provisions. That was a path pursued by the creators of the Directive 2014/104/EU of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the Member States and EU competition law provisions. This paper analyses the development of tort liability for the infringements of competition law within the European Union law, but also in Croatia, where such damages claims are still an exception. After the adoption of the Procedure on damages actions for infringements of the competition law Act in July 2017, the situation could be different. New Act contains substantive and procedural law provisions, which put injured market participants in better position in achieving their right to damages award.*

**Keywords:** *competition law, damages claims, Directive 2014/104/EU, tort liability, Procedure on damages actions for infringements of the competition law Act*

### 1. INTRODUCTION

The most important provisions of European competition law are Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU). These provisions are dealing with prohibited agreement, decision, practices, and abuse of dominant position, thus imposing obligations on private legal individuals not to behave in certain ways (Whish/Bailey, p. 84-182; 183-225). National competition law provisions are governed in the same manner as in the European Union (EU). Efficient enforcement of competition law provision is not accomplished only through public enforcement by way of decision taken by the public authorities. Issue of private interests of market participants are left aside. For that reason, it was necessary to provide conditions ensuring private protection of rights of injured participants in cases of alleged infringement of the competition law. In other words, this was a rather underdeveloped area of law. After the adoption of the Regulation 1/2003, first step in developing private enforcement of competition law in EU occurred throughout case law of the Court of Justice of the European Union (CJEU) where it was clearly stated that any individual has the right to claim damages for loss caused by a contract or conduct in breach of Art. 101 (1) TFEU. Case law on right to damages was followed by the work of European Commission dealing with the obstacles in national laws of the Member States in achieving damages award. The result was the subsequent adoption of the Directive 2014/104/EU, containing special substantive and procedural rules which suppose to facilitate the burden of proof for the injured person. In regard to the position of injured person in Croatian private law, the situation has changed after the implementation of the Directive 2014/104/EU.

The new Procedure on damages actions for infringements of the competition law Act (Act on antitrust damages actions) contains new rules which establish new type of tort liability.

## **2. DEVELOPMENT OF PRIVATE ENFORCEMENT OF COMPETITION LAW IN THE EUROPEAN UNION**

Private enforcement of competition law is rooted in the US antitrust laws regulated in Sherman and Clayton Acts (Müller, 2010, p. 31-106; Jones, 2016, p. 19-26). The US system of antitrust damages action was a foundation for the EU institutions in creating European rules on damages actions in competition law, but EU model represents a different system from the American. Considering direct effect of TFEU provisions, private enforcement of competition law in the EU refers to the application of the Art. 101 and 102 TFEU by individuals or undertakings in civil proceedings before the national courts of the Member States (Milutinović, 2010, p. 14.). Private party affected with the infringement of competition law can obtain civil law remedies, such as nullity of a contractual obligation, injunction, or an award of damages. Obtaining damages award, although possible in theory, was quite rare in practice due to difficulties in proving conditions of tort liability: breach of competition law provision, sustained harm, and a causal relationship between the harm and an infringement of competition law provision.

### **2.1. Case law of the CJEU on right to damages award**

Seminal case law of CJEU underlying right to damages for the infringement of EU competition law are *Courage* and *Manfredi*. In both cases, the CJEU heard preliminary references (Art. 267 TFEU) from the national courts about scope of tort liability. In *Courage v. Crehan*, the dispute was between Mr Crehan, a landlord of a public house who had signed a 20-year tied-brewery lease with the *Courage* brewery, agreeing to purchase a fixed minimum quantity of beer exclusively from the brewery. Their agreement was very financially adverse for Crehan who was not able to fulfil his obligations, so *Courage* brought an action for the recovery of certain sum for unpaid deliveries of beer. Crehan contested the action on its merits, contending that the beer tie was contrary to Art. 101 (1) TFEU and also counter-claimed for damages. Crehan was arguing that *Courage* sold its beers to independent tenants of pubs at substantially lower prices than those imposed to tenants subject to a beer tie, resulting in reduced profitability of tied tenants, driving them out of business. English court found two major obstacles in counterclaim according to the English law. Firstly, the interpretation of Art. 101 (1) TFEU was usually understood as aiming to protect only competitors and consumers, but never a party to a potentially illegal agreement. Secondly, English law contains rule of *in pari delicto* (lat. in equal fault), meaning that Crehan could not claim damages from other party, as he was also a party to the illegal agreement. The CJEU emphasizes the primacy of EU law over national law, meaning that Art. 101 (1) TFEU constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the EU and, in particular, for the functioning of the internal market (*Courage*, para. 20). In relation to the English rule of *in pari delicto*, the CJEU stressed that there should not be any absolute bar to a damages action being brought by a party to a contract which would be held to violate the competition rules (*Courage*, para. 28), whereas any individual can rely on a breach of Art. 101 (1) TFEU before a national court even where he is a party to a contract that is liable to restrict or distort competition (*Courage*, para. 24). The CJEU was not referring to the compensation only; it also stressed the importance of deterrence effect of such a right strengthening the efficiency of the EU competition rules, simultaneously discouraging those frequently covert agreements or practices, liable to restrict or distort competition, and making actions for damages before the national courts as significant contribution to the maintenance of effective competition in the EU (*Courage*, para. 27). Considering all, *Courage* judgment places on equal footing the compensation and deterrence rationale (Lianos/Davis/Nebbia, 2015, p. 17).

In *Manfredi*, three consumer actions were disputable before Italian courts in order to obtain damages award from insurance companies for repayment of the increase in the cost of premiums for compulsory civil liability insurance relating to accidents caused by motor vehicles, vessels and mopeds paid due to the increases implemented by those companies under an agreement declared unlawful by the national competition authority. At the time of proceeding, under Italian competition law, consumers were not entitled to claim compensation for loss resulting from an infringement of the national competition rules (Milutinović, 2010, p. 73). Other issues in proceedings were the scope of damages award and limitation period. The CJEU, after dealing with the issue of simultaneous application of national and EU competition law, confirmed the ruling that any individual can claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited under Art. 101 TFEU (*Manfredi*, para. 61). However, in the absence of EU rules governing the matter, it is for the domestic legal system of each Member State to prescribe the detailed rules governing the exercise that right, including those on the application of the concept of ‘causal relationship’, provided that the principles of equivalence and effectiveness are observed (*Manfredi*, para. 64). Also, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction to hear actions for damages based on an infringement of the EU competition rules and to prescribe the detailed procedural rules governing those actions, provided that the provisions concerned are not less favourable than those governing actions for damages based on an infringement of national competition rules and that those national provisions do not render practically impossible or excessively difficult the exercise of the right to seek compensation for the harm caused by an agreement or practice prohibited under Art. 101 TFEU (*Manfredi*, para. 72). The issue of limitation period was very significant due to the fact that the CJEU refers to the continuous and repeated infringements that may remain unpunished if time limits do not take this continuity in account. In that regard, it is for the national court to determine whether a national rule which provides that the limitation period for seeking compensation for harm caused by an agreement or practice prohibited under Art. 101 TFEU begins to run from the day on which that prohibited agreement or practice was adopted, particularly where it also imposes a short limitation period that cannot be suspended, renders it practically impossible or excessively difficult to exercise the right to seek compensation for the harm suffered (*Manfredi*, para. 82). As to the extent of the damages, the CJEU stated that it follows from the principle of effectiveness and the right of any individual to seek compensation for the loss caused by a contract or by conduct liable to restrict or distort competition that injured persons must be able to seek compensation not only for the actual loss (*damnum emergens*) but also for the loss of profit (*lucrum cessans*) plus interest (*Manfredi*, para. 95). Judgments in *Courage v. Crehan* and *Manfredi* proved to be a clear signal of the CJEU stressing the importance of private enforcement of EU competition law but also about principle of the availability of damages for breach of EU competition law as matter of EU law (*Manfredi*, para. 61.; *Ashton/Henry*, p. 16-23). It was time for the Commission to design rules on damages actions applicable in all Member States.

## **2.2. Green and White Paper on damages actions for breach of the EU antitrust rules**

The beginning of Commissions’ work in field of private enforcement of competition law and antitrust damages actions was in 2004, when a comparative report of a study on the conditions of claims for damages in case of infringement of EU competition rules (*Ashurst* report) was published. The study demonstrated underdevelopment of private enforcement of competition law in the Member States and the absence of right on compensation in practice. As a result of the *Ashurst* report, the Commission published in 2005 Green Paper on damages actions for breach of the EU antitrust rules with accompanying Commission Staff Working Paper (SWP 2005), aiming to look at ways in which damages actions for breach of EU antitrust rules before

national courts may be facilitated in order to better compensate victims and complement the enforcement activities of public enforcement authorities. As it was stated, damages actions for infringement of antitrust law serve several purposes, namely to compensate those who have suffered a loss as a consequence of anti-competitive behaviour and to ensure the full effectiveness of the EU antitrust rules by discouraging anti-competitive behaviour, deterrence, thus contributing significantly to the maintenance of effective competition in the EU (Green Paper, p. 4). The Commission concluded that failure to exercise right to damages is largely due to various legal and procedural hurdles in the Member States' rules governing actions for antitrust damages before national courts. In this document, Commission defined obstacles as follows: access to evidence; fault; damages (concept and calculation); the pass-on defence and indirect purchaser standing; defence of consumer interests; costs of actions; coordination of public and private enforcement; jurisdiction and applicable law; appointment of experts by the court; suspension of limitation period; and causation (Green Paper, points 2.1. to 2.9.). For each obstacle, Commission suggested several options (SWP 2005, p. 12-78). The Green Paper was received with broad interest in the antitrust community, which was also reflected in the substantial number of responses (Lianos/Davis/Nebbia, 2015, p. 23). The next step in the modernization of EU competition law was the White Paper on damages actions for breach of the EU antitrust rules and accompanying Commission Staff Working Paper (SWP 2008), published in 2008. White Paper considers and puts forward proposals for policy choices and specific measures that would ensure that all victims of infringements of EU competition law have access to effective redress mechanisms so that they can be fully compensated for the harm they suffered (White Paper, point 1.2.). As a result of concerns expressed in the response to the Green Paper, but also the Manfredi judgment, some issues were left aside, such as causation (Milutinović, 2010, p. 81). White Paper is dealing with measures for: indirect purchasers' claims and collective redress; access to evidence *inter partes*; the binding effect of decisions of national competition authorities (NCAs); the requirement of fault as an element of civil liability; the definition and calculation of damages; the passing-on; limitation periods; costs of damages actions; and the relationship between leniency programmes and actions for damages (White Paper, points 2.1. to 2.9.). All of these issues represent vital areas where intervention is necessary in order to ensure effective damages action and for each of them Commission brought a recommendation. In relation to standing to sue, there should be no *a priori* limitation on categories of persons that can claim damages, meaning that any person that can show the existence of an infringement, damage and a causal link between the two should be entitled to claim (SWP 2008, points 33-37). Representative actions and opt-in collective actions should be introduced at EU level (SWP 2008, points 48-59). Regarding access to evidence, judicial orders for *inter-partes* disclosure of 'precise categories of relevant evidence' should be introduced (SWP 2008, points 98-109). Corporate statements given by cartel participants for the purposes of leniency should receive adequate protection from disclosure in civil proceedings (SWP 2008, points 118-120). Final decisions on infringement of NCAs should have binding effect on national courts throughout the EU (SWP 2008, points 142-151). Commission suggests that the element of fault, as a requirement of civil liability, should be limited to the absence of an 'excusable error' on the part of the defendant, without prejudice to those systems where strict liability is already in place (SWP 2008, points 173-179). Victims of an EU competition law infringement are entitled to particular damages, such as exemplary or punitive damages, if and to the extent such damages may be awarded pursuant to actions founded on the infringement of national competition law (SWP 2008, points 185-190). Also, the *acquis communautaire* with regard to the types of damage should be codified (SWP 2008, points 193-195). Indirect purchasers who did not buy overpriced products directly from a cartel or dominant undertaking should benefit from a rebuttable presumption that the anticompetitive overcharge was passed-on to them through the supply chain (SWP 2008, points 215-220).

Limitation periods should not start to run: a) in case of a continuous or repeated infringement before the day on which the infringement ceases; b) generally, before the victim of the infringement can reasonably be expected to have knowledge of the infringement and of the harm it caused him (SWP 2008, points 232-235). In addition, a new limitation period of a minimum of two years starts to run once the infringement decision on which the claimant relies in his antitrust damages action has become final (SWP 2008, points 236-240). Commission suggests limiting the civil liability of the immunity recipient to claims by his direct and indirect purchasers (SWP 2008, points 303-306). As it can be seen, the Commission's objective is to create an effective system of private enforcement through damages actions as a complement to, and not a substitute, for public enforcement. Subsequently, these measures are designed in such a way as not to jeopardise public enforcement.

### **3. DIRECTIVE 2014/104/EU ON ANTITRUST DAMAGES ACTIONS**

Directive 2014/104/EU was signed into law on 26 November 2014, but the deadline for the implementation into Member States' legal systems expired on 27 December 2016. Text of the Directive 2014/104/EU represents final position on issues dealt in Green and White Paper, except regulation of collective redress (Lianos/Davis/Nebbia, 2015, p. 33). The rules of the Directive 2014/104/EU are aimed at securing the right to compensation for natural and legal persons who have suffered harm caused by infringements of competition law, but also as deterrence for future violation of competition law provisions (Recitals 6-9 of the Directive 2014/104/EU). The EU model of antitrust damages action established by the Directive 2014/104/EU in conjunction with existing case law of the CJEU will not counterpart to private litigation under American model of antitrust damages action (Bernitz, 2016, p. 7). This Directive is not a full harmonisation directive, since Member States have plenty space for introducing even more advanced rules as long as these rules do not conflict with the requirements of the Directive.

#### **3.1. Scope of the Directive 2014/104/EU**

Art. 3/1 provides that any person who has suffered harm caused by an infringement of competition law is able to claim and to obtain full compensation for that harm, meaning that it shall cover the compensation for actual loss and for loss of profit, plus the payment of interest (Art. 3/2). These provisions cover wide range of possible claimants, from upstream suppliers or downstream purchaser, to indirect purchaser and even parties outside of supply chain affected by the anticompetitive practices. Art. 17/2 provides a rebuttable presumption with the regard to the existence of harm which is result of cartel infringement, intending to decrease information asymmetry. Next step in removing information asymmetry can be seen in provisions concerning disclosure of evidence. In accordance with the principle of effectiveness, Member States shall ensure that all national rules and procedures related to the exercise of claims for damages are designed and applied in such a way that they do not render practically impossible or excessively difficult the exercise of the Union right to full compensation for harm caused by an infringement of competition law (Art. 4). In accordance with the principle of equivalence, national rules and procedures relating to actions for damages resulting from infringements of Article 101 or 102 TFEU shall not be less favourable to the alleged injured parties than those governing similar actions for damages resulting from infringements of national law (Art. 4). In relation to the disclosure of evidences, the Directive contains separate rules. Art. 5/1 provides that when claimant has presented a reasoned justification containing reasonably available facts and evidence sufficient to support the plausibility of claim for damages, national courts are able to order the defendant or a third party to disclose relevant evidence which lies in their control. According to the Art. 5/2 national courts are able to order the disclosure of specified items of evidence or relevant categories of evidence circumscribed as precisely and as narrowly as



possible on the basis of reasonably available facts in the reasoned justification. Art. 5/3 introduces a general requirement that the proportionality assessment implies a balancing of legitimate interests of all parties and third parties concerned. Art. 6 is regulating disclosure of evidence included in the file of a competition authority. Temporary protection is granted to the information prepared during a competition authority's investigation, i.e. the information that was prepared by a natural or legal person specifically for the proceedings of a competition authority, or the information that the competition authority has drawn up and sent to the parties in the course of its proceedings and settlement submissions that have been withdrawn. These categories may be ordered for disclosure only after a competition authority, by adopting a decision or otherwise, has closed its proceedings (Art. 6/5). Protection from disclosure is granted to leniency statements and settlements submissions (Art. 6/6). These categories of evidences are always excluded from disclosure because they are considered to be crucial for the effectiveness of public enforcement tools. Art. 7 further safeguards for the preservation of the effectiveness of public enforcement so if a party has obtained leniency corporate statements and settlement submission through access to the file of a competition authority is either deemed to be inadmissible in actions for damages or is otherwise protected under the applicable national rules. In accordance with Art. 16/1 of Regulation 1/2003 (national courts cannot take different decision on agreements, decisions, or practices under Art. 101 or 102 TFEU, which are already the subject of a Commission decision), claimants who bring actions for damages before national courts subsequent to a Commission decision can rely on the latter directly as irrefutable proof that an addressee of the decision infringed Art. 101 or 102 TFEU. Art. 9/1 of the Directive introduces a similar principle for the decisions of NCAs within Member States, by providing that an infringement of competition law found by a final decision of a national competition authority or by a review court is deemed to be irrefutably established for the purposes of an action for damages brought before their national courts under Article 101 or 102 TFEU or under national competition law. Yet, where a final decision is taken in another Member State, that final decision may be presented before their national courts as at least prima facie evidence that an infringement of competition law has occurred and, as appropriate, may be assessed along with any other evidence adduced by the parties (Art. 9/2). Art. 10 sets out limitation period for bringing actions for damages. Limitation periods shall not begin to run before the infringement of competition law has ceased and the claimant knows, or can reasonably be expected to know: a) of the behaviour and the fact that it constitutes an infringement of competition law; b) of the fact that the infringement of competition law caused harm to it; and c) the identity of the infringer (Art. 10/2). Art. 10/3 introduces a minimum limitation period for bringing actions for damages of five years, while Member States are left free to decide about maximum duration. Rule of joint and several liability can be found in Art. 11, meaning that the undertakings which have infringed competition law through joint behaviour are jointly and severally liable for the harm caused by the infringement of competition law; with the effect that each of those undertakings is bound to compensate for the harm in full, and the injured party has the right to require full compensation from any of them until he has been fully compensated. Also, there are introduced a safeguard for small and medium enterprise (Art. 11/2), and to an immunity recipient (Art. 11/4) regarding their limited liability for harm only to its own direct and indirect purchasers. The Directive clarifies the rules on passing-on and indirect purchasers. Art. 12 provides that Member States shall ensure that the compensation of harm can be claimed by anyone who suffered it, irrespective of whether they are direct or indirect purchasers from an infringer, and that compensation of harm exceeding that caused by the infringement of competition law to the claimant, as well as the absence of liability of the infringer, are avoided. The defendant an action for damages can invoke as a defence against a claim for damages the fact that the claimant passed on the whole or part of the overcharge should weight on the defendant (Art. 13).

Indirect purchasers will be able to claim damage compensation upon proving: the defendant has committed an infringement of competition law; the infringement of competition law has resulted in an overcharge for the direct purchaser of the defendant; and the indirect purchaser has purchased the goods or services that were the object of the infringement of competition law, or has purchased goods or services derived from or containing them (Art. 14). Quantification of harm is mentioned in Art. 17/1, only by providing that Member States shall ensure that neither the burden nor the standard of proof required for the quantification of harm renders the exercise of the right to damages practically impossible or excessively difficult. National courts are empowered, in accordance with national procedures, to estimate the amount of harm if it is established that a claimant suffered harm but it is practically impossible or excessively difficult precisely to quantify the harm suffered on the basis of the evidence available. Based on the Art. 18 and 19, the Directive seeks to promote the use of consensual dispute resolution, by providing that national limitation periods are suspended for the duration of any consensual dispute resolution process. For that reason, national courts may suspend proceedings for up to two years where the parties are involved in consensual dispute resolution concerning the claim covered by that action for damages. To avoid overcompensation of claimant, national courts must take account of any settlement relating to a particular infringement, so any remaining claim of the settling injured party shall be exercised only against non-settling co-infringers.

#### **4. ANTITRUST DAMAGES ACTION IN CROATIAN LAW**

Competition law in Croatia is regulated by the Competition Act (CA), while the Competition Agency, as national competition authority, has competences to investigate and decide on breaches of the CA. Prior to the implementation of the Directive 2014/104/EU, relevant provision on antitrust damages actions was Art. 69a of the CA, which grants jurisdiction for antitrust damages claims to commercial courts. This Article expressly provides that the right for compensation for damages exists regardless of whether Croatian or EU competition law is infringed (Josipović, 2016, p. 72). There were no other substantive and procedural rules in CA relevant for the exercising of compensation for damage caused by the breach of competition law provisions. As a consequence, in case of damage caused by the breach of competition law only rules for extra-contractual (tort) liability set out in the Obligation Act (OA) and general procedural rules laid down in the Civil Procedure Act (CPA) could be applied (Josipović, 2016, p. 74-78; Pecotic-Kaufman, 2012, p. 6-35).

##### **4.1. New rules on tort liability for damages caused by the breach of competition law**

In July 2017 the Procedure on damages actions for infringements of the competition law Act was adopted. With this new Act Croatia completed its obligation to implement the Directive 2014/104/EU into national legislation, although was in delay for several months. Act on antitrust damages action brought some new substantive and procedural provisions, which put injured market participants in better position in achieving their right to damages award. To obtain damages award injured person must prove a breach of competition law provision, sustained harm, and a causal relationship between the harm and an infringement of competition law provision. Since this Act is *lex specialis* for antitrust damages actions, all issues not regulated within this Act, are governed by the OA and CPA (Art. 4). Art. 5/2 provides strict liability rule, meaning that a person who has caused damages by breaching competition law provision is liable for that damage regardless of his fault. This rule is novelty, since Art. 1045/1 and /2 of the OA provided fault-based liability and the principle of presumed fault. Art. 1 recognizes the principle of full compensation, meaning that a person injured because of a infringement of competition law will have the right to compensation for pure economic loss and loss of profit, and the interest running from the moment of the caused damage.

Art. 5/1 states that injured person will be compensated for material damage and non-material damage, and default interests. Art. 5/3 provides the presumption that breach of competition law committed by cartel result in damage, unless the injurer proves contrary. Art. 5/4 states that damage which is result of the breach of competition law committed by cartel is caused by that cartel, unless it is proven that that cartel not caused damage. Art. 11 deals with effects of NCA decision. In line with the rule of Art. 11/1 the infringement of competition law found by a final decision of the Competition Agency or by a High Administrative Court is deemed to be irrefutably established for the purposes of an action for damages brought before national courts. Art. 11/2 states where a final decision for the infringement of Art. 101 and 102 TFEU is taken in another Member State, that final decision of NCAs or by courts is deemed to be established for the purposes of an action for damages, unless it is proven contrary. Art. 12 regulates limitation periods, the suspension and the interruption of limitation periods differently than Art. 230 of the OA. It states that the damages actions must be brought within 5 years from the moment the infringement of competition law has ceased and from the moment claimant knew or might knew about the infringement, the harm and identity of injurer. The objective limitation period of 15 years runs from the moment of the cessation of the infringement of competition law. Art. 13 regulates suspension of proceedings. Parties in the first and second instance proceedings may request the court in accordance for the suspension, for an attempt to settle the dispute. The suspension of proceedings may last for two years. According to the Art. 186g of the CPA the same possibility was available, the suspension could last for one year but possible to extend for one year more. In the Act on antitrust damages issues of disclosure of evidences (Art. 6-9), joint and several liability (Art. 14), passing on defence and indirect purchasers (Art. 15-16), quantification of harm (Art. 17), use of consensual dispute resolution (Art. 18) actions are regulated in the same manner as in the Directive 2014/104/EU. These issues are now provided in much more details comparing to the general rules in the OA and CPA.

## 5. CONSLUSION

Directive 2014/104/EU contains plenty of significant new solutions aimed to achieve effective enforcement of competition law provisions in the EU. To ensure effective private enforcement of damages actions and effective public enforcement by competition authorities, both tools are required to interact to ensure maximum effectiveness of the competition rules (Recital 6 of the Directive). Following that path, rules are shaped in a way to accomplish not only compensation element, but also the deterrence one. The Directive 2014/104/EU rules promote the use of follow-on actions instead of encouraging injured person for stand-alone action for damages award. The lack of the promotion of stand-alone action leads to irrelevant contribution both to the probability that an infringing conduct is detected and to the liability exposure of the infringing party (Renda, 2016, p. 298). Other downsides of the Directive 2014/104/EU are the absence of the features of the US private antitrust enforcement: contingency fees, opt-out class action, and discovery rules. Croatian general substantive and procedural rules were not designed to facilitate antitrust damages claims, causing lack of the relevant case law. Implementation of the Directive 2014/104/EU has a potential to institute new rules for injured persons to exercise right on damages award in Croatian legal system. Adopted Act on antitrust damages actions establishes new type of tort liability, containing detailed provisions for obtaining damages award in cases of the infringement of competition law. At the same time, this Act contributes to the creation of legal certainty within Croatian private law regarding breach of competition law provisions.

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## SCIENTIFIC AND TECHNOLOGICAL «BREAK» IN RUSSIA: CAPACITY OF MONOPOLISTIC STRUCTURES

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### ABSTRACT

*Today large corporations are the dominating structures in the Russian economy. The corporate sector of the country is presented mostly by oligopolies and monopolies. The share of such structures in Russian GDP makes about 70% by estimates of some experts. Fuel and energy complex, metallurgy, mechanical engineering, electric power, transport, telecommunications, trade dominate among sectors of monopolistic structures. As for the contribution to scientific and technological development of national economy the problem of monopolistic structures capacity is relevant. Transition to a new technological way is relevant for the Russian economy. Only large business has financial and economic potential for such transition. It is capable to concentrate those large resources which are necessary for modernization of the Russian economy. Moreover, large business has access to information resources that are one of the “driver” of national scientific and technological development for today. The purpose of our research is to estimate the capacity of large monopolistic structures concerning scientific and technological development of the country. In the research the authors show the review of monopolistic structures in Russia. The nature of scientific and technological development of national economy is investigated in the paper. The authors have developed the evaluation technique of the contribution of such structures to scientific and technological development of the country. The authors use quantitative methods of the analysis of a contribution of monopolistic structures to scientific and technological development of Russia.*

**Keywords:** *scientific and technological development of Russia, monopolistic structures, large business, role of large business in modernization of economy*

### 1. INTRODUCTION

The priority of Russian economy today – to reach the new level of development, to get the following technological way. The scientific and technological break is impossible without the financial base. In the modern global world the technology factor becomes decisive in ensuring competitiveness, national security and long-term economic growth. Large firms concentrate the financial resources that are necessary for national technological growth and development. Today Russian corporate sector is represented mostly by monopolistic structures. The purpose of this paper – to look differently at effects of monopolies, than it is accepted in a neoclassical paradigm.

It is necessary to recognize existence of a huge amount of positive effects of monopolies despite the standard negative perception of monopolies. Today many economists agree that the potential of extensive growth (based on expansion of resource factors: the capital and work) in Russia is almost exhausted. The economy needs the breakthrough technologies capable to change production structure and productivity of all economic system qualitatively. In our opinion, only large economic subjects (which at the same time often hold a dominant position in the branch markets) can make this break. The purpose of this work is to reveal a role of monopolistic structures in ensuring innovative activity in Russia.

## 2. DISCUSSIONS

The questions concerning development of innovations, technologies in economic literature are being researched since formation of modern industrial corporation. In the 1990th it has been recognized that innovative activity of the enterprises is a strategic factor of the market, including a part of firm's strategy directed to gain the market power. Classical authors A. Smith, A. Marshall assumed that economic development is connected only with the free market competition. According to A. Smith, the monopoly is «the great enemy of good economy» as only competition leads to «good housekeeping for the benefit of self-defense» (Smith, 1776). K. Marx (Marx, 1984) proves a crucial role of the large companies in scientific and technical progress. He shows that the increase in productivity of work occurs due to increasing in a share of production means, application of the technological innovations replacing manual skills. J. Schumpeter, the famous scientist in the field of innovations and economic development, allocated in the competition both the creative and destroying parts as the competition leads to bankruptcy of many firms. This author also considered that the monopoly is only a competition form (Schumpeter, 1942). J. Schumpeter distinguished ability to effective accumulation of resources for financing the additional investments as the main positive effect of monopoly. Also the monopolist can use those ways of production which are inaccessible for smaller competitors. The monopolies often have stronger financial position and more opportunities for scientific and technical progress. The monopolist, first, has large sums for innovations, and, secondly, receives a rent from innovations that is also an incentive for scientific and technical progress. According to J. Schumpeter's opinion, large monopolies are more innovatively active as they own the necessary capital, bigger ability to spread risk and positive scale from innovations. According to K. Arrow's researches, the successful innovation brings a bigger prize for competitive firm, than for the monopolist under equal initial conditions of demand and functions of expenses (Arrow, 1962). The reason is: for the competitor any income from an innovation – a prize, but the monopolist gets profit anyway. The competitive market demands from a firm a preservation of the previous level of the output and the price therefore the innovation reducing expenses makes bigger profit in this market structure while the monopolist reduces the outputs after introduction of an innovation. Also in K. Arrow's model the monopolist spends less funds for innovations, than it is socially necessary. The monopolist "replaces" himself during innovative activity, and the competitor becomes a monopolist. At the same time the monopolist for preservation of the market power will seek to get the property rights to an innovation even without future use. That's why there is a problem of "the sleeping patents". But also the competitor, according to Arrow, spends for innovations much less resources, than it is necessary for maximizing public welfare. Therefore public planning of scientific and technical activity is more preferable, than market. If the innovation has decisive character, it is realized by the competitor if minor – by the monopolist. In confirmation of K. Arrow's ideas F. Scherer in the researches has shown that the small companies are more innovatively active (Scherer, 1982). By his estimates, in the USA the companies with a number of employees less than 1 thousand people (41,2%) make up to 47, 3% of important innovations, more than 10 thousand people (36%) – 34, 5% of innovations.

At the same time 72% of large innovations are made by private firms. It is interesting that large companies' expenses on research and development are 73% from total, but they get only 61% of all patent inventions and 55% of large innovations. So it means that the return from innovations is disproportionate to the size of a firm. J. Bound with co-authors show that height of 1% of sales to the company causes increase in expenses on research and development by 0, 7%, at the same time small and large companies show bigger innovative activity than medium-sized companies (Bound, 1984). In Russia N.M.Rozanova (Rozanova, 2002), Ya. Sh. Pappe (Pappe, 2002) and other authors are engaged in studying of innovative activity of the organizations in various types of market structures.

### 3. TECHNOLOGIES AND INNOVATIONS IN RUSSIA

We will consider the main tendencies characterizing a state and development of the scientific and innovative sphere of the domestic economy.

*Table 1: Share of production of high-tech and knowledge-intensive industries  
in GDP 2011-2017*

Years	2011	2012	2013	2014	2015	2016	2017
Share, %	19,7	20,3	21,1	21,8	21,3	21,6	21,7

*Source: Data of Rosstat*

[http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/economydevelopment/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/economydevelopment/#)

The share of high-tech production in structure of GDP of the Russian Federation makes a little more than 20% and from table 1 it is visible that it tends to gradual increase. If to consider some indicators in comparison with the developed countries, then it is possible to notice serious lag. So, for example, the volume of high-tech export from Russia in 2015 was 9, 7 billion dollars while from China – 554,3, from Germany – 185,6, from the USA – 153,5. The labor productivity in Russia is 25,9 dollars /man-hour while an average value of labor productivity over the countries of OECD – 50,8. Specific weight of the organizations which are carrying out technological innovations in Russia – only 8,8%, while in Germany – 55%, Sweden – 45,2%. Costs of research and development have made in 2015 only 1,1% of GDP, and in South Korea – 4,23%, Germany – 2,93%, the USA – 2,79% of GDP. By the number of the granted patents (24 998) Russia lags behind the developed countries more than ten times (Lenchuk, 2002). Some results of innovative activity in Russia in 2016 on the main sectors of economic activity are presented in table 2.

*Table following on the next page*



*Table 2: The results of innovative activity in Russia in 2016*

Sector of economic activity	Share in gross value added, %	The level of organizational innovative activity, %	Volume of innovative goods and services, billion rubles.	Share of innovative goods and services, %
Industrial production	-	9,2	3 723,7	8,4
Service industry	-	6,2	616,1	11,9
Construction	6,35	1,1	2,4	1,7
Agriculture	4,6	3,4	22,2	1,4
The processing production	13,3	11,8	-	10,9
The extracting branch	9,5	5,5	-	4,0
Production and distribution of the electric power, gas and water	3,34	4,1	-	2,3
High-technological	-	29,4	-	18,2
Medium-technological of high level	-	15,7	-	13,1
Medium-technological of low level	-	10,4	-	11,1
Low-technological	-	6,6	-	4,8

*Source: Indicators of innovative activity: 2018. Statistical report.*

[https://www.hse.ru/data/2018/03/23/1164003717/Indicators\\_of\\_Innovation\\_2018.pdf](https://www.hse.ru/data/2018/03/23/1164003717/Indicators_of_Innovation_2018.pdf)

It is possible to see that the greatest innovative activity is shown by the organizations in the sector of the processing and industrial production on the presented data. These sectors also show the maximum volume of innovative goods. The services sector lags behind on indicators of innovative activity almost twice, the construction sector shows the minimum values of this indicator – just 1, 1%.

#### **4. ANALYSIS OF INNOVATIVE ACTIVE SUBJECTS**

It is important to allocate those subjects who show innovative activity while studying the problem of innovations in the Russian economy. The main subjects are individual inventors and business. Individual inventors are the people who are engaged in inventions ("garage innovations") for personal reasons. According to the experts of Higher School of Economics from National Research University, a share of such population in Russia – 9, 6%. That is much higher than in other countries: in Great Britain – 6, 1%, the USA – 5, 2%, the Republic of Korea – 1, 5% (Petrova N., 2018). At the same time by the level of patent activity our country takes the last place in the list of the explored countries - only 373 applications for 1 million economically active population a year, in comparison with Switzerland where about 9 thousand applications. This is an extremely low indicator. Thus, it turns out that the inventive activity of individual inventors is almost not demanded by business and never finds a commercialization form. The second and main subject of innovative activity is business, and here it is important to understand what enterprises in the long term can make the technological break which is so necessary for economy. Division of the enterprises on small, medium and large is standard. Large business plays the main role in the national economy, its contribution to GDP is estimated at 79%. The share of small and medium firms is about 21%, at the same time the share of the state ownership in 10 largest companies makes 81%. Subjects of small business show very low innovative activity as it is shown in table 3. Small firms strongly depend on the identity of the founder as a rule and also treat family business.

They can play an important role, for example, in providing city infrastructure, but at the same time can hardly apply for ensuring technological break. That is caused by their low role in economy and a lack of resources for active innovations. Among the medium-sized business there are rather effectively developing technological companies – "gazelles". We will address the National rating of the Russian fast-growing technological companies made by the Ministry of Economic Development and Higher School of Economics. This rating has data on 220 companies. Selection criteria of the companies in rating are: 1. Medium business — revenue size: from 120 million to 30 billion rubles. 2. High-growth business — average annual growth rate of revenue: not less than 15-20% for the last five years. 3. Technological business — for the last three years a share of average costs of research and development — not less than 5%, on technological innovations — not less than 10%, a share of new or significantly improved production — not less than 20-30% of total sales.

*Table 3: Distribution of the companies-"gazelles" by industries, 2016*

Industry	Revenue, million rubles	Number of companies	Share of expenses on research and development	Share of expenses on technological innovations
Biotechnologies, pharmaceuticals, medical equipment	23 958	12	11	20
Informational technologies	44 068	15	10	15
Materials	20 312	13	13	33
Mechanical engineering, industrial equipment, electronics and instrument making	131 492	53	19	26
Oil and gas equipment and power	2 316	6	6	13
Consumer goods	199	1	7	12

*Source: made by authors based on the National rating of the Russian fast-growing technological companies [2].*

In the long term, medium business can become the base for innovative break, however today its contribution to economy is low and also there are certain problems with stability of its innovative results. Often fast-growing companies due to explosive growth have problems with further development and counteraction to the increasing pressure of slower competitors. The mechanical engineering, electronics and instrument making are the clue industries where Russian "gazelles" act. Large business is that sector which makes the main contribution to economy of Russia today and it is under considerable control of the state. It is logical to assume after J. Schumpeter that large companies are the main subjects of innovative activity and they can make scientific and technological break. Data on innovative activity of the enterprises depending on the organization size is presented in the following table.

*Table following on the next page*

*Table 4: Innovative activity depending on the size of the organization*

Number of employees of the organization, persons	Cumulative level of innovative activity, %		Share of the organizations which were carrying out innovations of different types in the total number of organizations, %					
	2015	2016	technological		marketing		organizational	
			2015	2016	2015	2016	2015	2016
In total	9,3	8,4	8,3	7,3	1,8	1,4	2,7	2,4
Less than 50	2,7	2,5	2,1	2,0	0,4	0,4	0,7	0,7
50-99	7,2	6,4	6,1	5,1	1,2	1,1	1,7	1,7
100-199	10,1	9,3	9,0	8,1	2,0	1,4	2,5	2,2
200-249	13,4	12,4	11,9	11,0	2,3	2,0	3,3	3,0
250-499	16,4	15,4	14,7	13,6	2,9	2,8	4,2	3,7
500-999	26,8	25,0	24,1	22,2	5,9	4,7	8,3	7,5
1000-4999	46,5	44,5	44,3	41,9	9,6	8,7	17,3	15,9
5000-9999	71,1	75,8	69,5	74,2	13,3	15,3	34,4	32,3
More than 10000	83,7	82,7	83,7	80,8	14,0	15,4	48,8	48,1

*Source: Indicators of innovative activity: 2018. Statistical report.*

[https://www.hse.ru/data/2018/03/23/1164003717/Indicators\\_of\\_Innovation\\_2018.pdf](https://www.hse.ru/data/2018/03/23/1164003717/Indicators_of_Innovation_2018.pdf) [3].

The level of innovative activity depends on the size of the organization. The sharp growth of innovative activity – almost twice – is observed in the organizations over one thousand people as we can see from table 5. The large organizations with number of staff more than 10 000 people show the highest innovative activity. More than 80% of such organizations carry out technological innovations – the most demanded type of innovations, marketing innovations are made just by 15,4% of large companies in 2016. About 48% of the large companies carry out organizational innovations. These data confirm our hypothesis that large business is the main driver of the economic development based on innovations.

*Table 5: Costs of technological, marketing, organizational innovations depending on the size of the organization*

Number of employees of the organization, persons	Costs of technological, marketing, organizational innovations			
	Billion rubles		%	
	2015	2016	2015	2016
In total	1 211 294,4	1 298 444,5	100	100
Less than 50	8 039,7	8 956,5	0,7	0,7
50-99	17 581,2	12 042,1	1,5	0,9
100-199	32 948,2	37 925,3	2,7	2,9
200-249	12 229,6	21 620,1	1,0	1,7
250-499	62 753,8	74 766,2	5,2	5,8
500-999	162 074,3	151 117,3	13,4	11,6
1000-4999	580 541,0	668 845,3	47,9	51,5
5000-9999	188 186,0	179 584,9	15,5	13,8
More than 10000	146 940,5	143 586,9	12,1	11,1

*Source: Indicators of innovative activity: 2018. Statistical report.*

[https://www.hse.ru/data/2018/03/23/1164003717/Indicators\\_of\\_Innovation\\_2018.pdf](https://www.hse.ru/data/2018/03/23/1164003717/Indicators_of_Innovation_2018.pdf) [4].

Based on the data presented in table 5 it is possible to make the following conclusions. The size of costs of innovations depends on the size of the organization. The greatest costs of innovations are carried out by large business (the number of workers from 500 people is one of signs of large business too). About 89% of total costs of innovations in 2015 and 88% in 2016 are made by the enterprises numbering from 500 and more people. It also confirms our idea that large business generally has resources for implementation of innovative activity.

*Table 6: Innovative activity of the organizations depending on ownership's forms*

Types of ownership	Cumulative level of innovative activity, %		Specific weight of the organizations which were carrying out innovations in the total number of organizations, %					
			technological		marketing		organizational	
	2015	2016	2015	2016	2015	2016	2015	2016
Total	9,3	8,4	8,3	7,3	1,8	1,4	2,7	2,4
Russian property	9,2	8,3	8,1	7,3	1,7	1,4	2,7	2,4
State	10,4	9,3	9,3	8,2	1,4	1,0	2,8	2,8
Federal	16,1	1,5	14,9	12,2	2,1	1,4	3,9	4,0
Property of subjects of RF	4,6	4,6	3,4	3,6	0,8	0,6	1,7	1,5
Municipal	2,7	2,7	2,3	2,3	0,3	0,3	0,9	0,9
Property of public organization	4,4	3,0	4,1	2,7	0,6	0,2	0,3	0,5
Private ownership	10,0	8,9	8,9	7,7	2,1	1,7	2,8	2,3
Property of consumer cooperation	4,1	3,1	4,1	3,1	2,0	1,0	-	-
Mixed	19,6	17,3	18,0	15,9	4,9	3,4	7,6	6,3
Mixed with state share	22,0	19,1	20,1	17,5	6,1	3,9	8,6	6,6
Other mixed property	14,3	13,0	13,4	11,9	2,0	2,2	5,5	5,6
Property of state corporations	34,8	34,0	32,4	31,3	5,3	6,7	12,1	10,8
Foreign property	8,4	7,0	7,5	5,9	1,8	1,4	2,1	1,9
Joint Russian and foreign property	13,8	12,7	12,3	10,9	2,6	2,9	4,1	3,5

*Source: Indicators of innovative activity: 2018. Statistical report.*

[https://www.hse.ru/data/2018/03/23/1164003717/Indicators\\_of\\_Innovation\\_2018.pdf](https://www.hse.ru/data/2018/03/23/1164003717/Indicators_of_Innovation_2018.pdf) [4].

Studying the structure of property of innovative firms, it is possible to see that the greatest activity is shown by the state corporations – more than three times their indicators exceed averages. Mixed with the state participation companies get the second place of the level of innovative activity. Approximately identical indicators are shown by the state federal and other mixed ownership. The private property shows rather low innovative activity that also confirms the ideas of some researchers (Arrow, 1962) that private business is not always able to carry out innovations at that level which is necessary for society, and non-market planning of innovations is necessary. The concept of large business is an important question of the scientific analysis. Ya. Sh. Pappe considers that as criteria of the large enterprises we can use sales volume, the value added and capitalization (Pappe, 2002).

This author suggests to use the following criteria: for the large enterprises of the oil and gas and coal industry – over 100 million dollars, and for other industries – over 10 million dollars – for the large companies of the oil and gas industry – over 500 million dollars, and for other branches – over 100 million dollars.

## 5. RESULTS: ANALYSIS OF INTERRELATION OF MARKET CONCENTRATION AND INNOVATIVE ACTIVITY

At the following stage of our research, authors estimate correlation between the level of market concentration and innovative activity of the enterprises. Firstly, the following indicators have been calculated for five branches: CR<sub>3</sub> (sum of market shares of three largest companies of the industry), CR<sub>7</sub> (sum of market shares of seven largest companies of the industry) and Herfindahl-Hirschman index (sum of squares of market shares of all companies). We assume that concentration allows to estimate level of monopolization of branch though, perhaps, and in a certain measure only indirectly, nevertheless these indicators are available from the point of view of statistics. Indicators of concentration have been calculated on the basis of revenue according to statistical base FiraPro. Results of the analysis are given in table 7.

*Table 7: Concentration indicators in industries in 2014*

Indicators	Oil and gas production	Metallurgy	Chemical production	Food production	Paper and pulp-and-paper production
CR <sub>3</sub> , % (x <sub>1</sub> )	46,21	23,63	13,08	6,3	27,18
CR <sub>7</sub> , % (x <sub>2</sub> )	56,98	40	22,2	13,31	36,56
HHI (x <sub>3</sub> )	1313,61	322	123,04	43,67	347,93
Share of organization with innovative activity, % (y <sub>1</sub> )	7,4	13	21,4	10,3	2,8
Distribution of costs on technological innovations, % (y <sub>2</sub> )	4,8	6,9	7,9	3,4	0,8

*Source: Calculated by authors*

The most concentrated market is the oil and gas production industry, but the concentration indicators show that it can be defined as a market with medium concentration. Other branches, in particular food and chemical production, are the markets with the low level of concentration. At the following stage the correlation analysis between indicators of concentration and the level of innovations has been carried out. Results of the correlation analysis are presented in table 8.

*Table 8: Results of the correlation analysis*

Coefficient of correlation	Y <sub>1</sub>	Y <sub>2</sub>
X <sub>3</sub>	-0,3982	-0,0536
X <sub>2</sub>	-0,4269	-0,0277
X <sub>1</sub>	-0,4903	-0,1315

*Source: Calculated by authors*

## 6. CONCLUSION

The correlation analysis has shown the following: between market concentration and a share of innovatively active organizations there is moderate inverse correlation. The correlation between a share of costs of innovations and market concentration is not statistically significant. Thus, at this investigation phase it is impossible to claim that monopolistic structures are more inclined to innovative activity in spite of the fact that they have more resources. However, this subject, certainly, demands a further more study with exploring of bigger number of industries and the temporary periods. The data the authors have studied shows that Russian economy needs more active policy in the field of scientific and technological development. Most indicators are much lower than in other developed countries. State large corporations are the most innovatively active subjects, and small and medium business does not play significant role in the economy.

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## POVERTY AS A PROBLEM OF THE GLOBALIZED WORLD

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### ABSTRACT

*Globalisation brings many opportunities but also has a number of negative effects. One of the most serious problems in the world today is poverty and social inequality. Poverty has a number of elements ranging from lack of material needs for dignified life across obstructed access to services or education to non-application to the labor market. These aspects lead to the fact that individuals and families find themselves in poverty, which is accompanied by social exclusion. In the Slovak Republic, we are seeing an increasing incidence of visible poverty caused by a change in the nature of poverty, from horizontal to vertical. The causes of poverty are mainly related to the loss of work. Loss of regular income leads to people's inability to secure basic living needs. New poverty affects the unemployed, people who are disadvantaged on the labor market, and people with low earnings - working poor. The disadvantaged groups on the labor market include people with health problems, with reduced working capacity, with low skills, ethnic groups, especially Roma. The paper focuses on the various aspects of poverty, its causes and the possibilities of solving poverty in the Slovak Republic.*

**Keywords:** *globalisation, poverty, working poor, unemployment, social inequalities*

### 1. INTRODUCTION

78 million people live in poverty or complete destitution in Europe (Halušková, Božik, 2015), which may be considered a grave injustice, given that it prevents access to basic living needs. The injustice related to poverty is also based on discrimination, whether on the basis of race, gender, religion, social class, nationality, language and even physical health, which is still deeply rooted in people's attitudes.

### 2. POVERTY AS AN UNDESIRABLE SOCIAL PHENOMENON

Poverty is a social phenomenon with three basic dimensions, an economic dimension, a political dimension and a socio-psychological dimension. Poverty in an economic sense may be based on differences in the accessibility of resources to the members of a society, including work, capital, land, mineral raw materials, knowledge and differences in the ability to exploit these resources. (Žilová, 2005). A person falls into economic deprivation (to a lower level, unable to afford the same as others in their social class), which is manifested in a reduction in their overall consumption, a deficit of items to meet their personal needs, and a reduction in spending on leisure activities. A lack of funds complicates the process of planning for the future and people live for the present. (Fedáková, 2003). The socio-psychological dimension of poverty involves social exclusion, a process that results in individuals being pushed to the fringes of society and thereby limiting their full participation in it as a result of their own poverty, a lack of basic skills and discrimination, leading to their disengagement from employment, a stable income and opportunities to learn. Excluded individuals may experience a disruption in their integrity, which is accompanied by a feeling of individual failure and shame, where a person loses faith in oneself and suffers from a general sense of insecurity. (Džambazovič, 2004). The political dimension of poverty includes social work, the basic principles of which are human rights and social justice.

Global poverty statistics document the absolute preponderance of poverty over a dignified life. People living in poverty lack access to the powers drafting poverty-related policies and are therefore denied efficient resources to rectify violations of their human rights as a legal being. 80% of the population lacks even a minimal system of social protection or security. (Halušková, Božik, 2015). A system of social protection was introduced in the Universal Declaration of Human Rights (2016) adopted by the United Nations on 10 December 1948. 12. 1948. Economic and social rights inevitable for the dignity of every person are contained in Articles 22 to 27. They include the right to work, the right to freely select employment, the right to fair and satisfactory working conditions, the right to protection from unemployment and the right to equal pay for equal work. With respect to working poverty, the declaration includes the right to remuneration for work performed. Remuneration should be fair and satisfactory and should provide workers and their families with a livelihood aligned with human dignity. With respect to social rights, mention is made of social security, social services and cultural rights, which are necessary to preserve human dignity and to ensure free personal development. In addition to the United Nations (the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights, the Declaration on the Rights of the Child, the Convention on the Rights of the Child), human rights are also taken up by the International Labour Organization (ILO Constitution), the Council of Europe (European Convention for the Protection of Human Rights and Fundamental Freedoms, the European Social Charter) and the European Union (Charter of Fundamental Rights of the European Union). These organisations monitor respect for human rights in all spheres of life, and complete reports and recommendations for all member states. (Halušková, Božik, 2015).

### 3. CAUSES OF POVERTY

Džambazović (2007) compares the search for the causes of poverty to a permanent process that has the objective of finding consensus on whom the state or a society will support, in what way and in what scope. Mention is also made of the obligations and entitlements of the poor in society that reflect the overall standard of living in that society. Formal solidarity in the social system has an impact on the informal solidarity with poor and socially excluded individuals, as well as the level of trust in the social system and self-reflection of the poor. Attitudes towards poverty range from making excuses to even blaming the poor, which Kerbo (In Kozubík, 2011) included in the three types of causes of poverty:

1. Poverty as a consequence of the configuration of a society's social and economic system - poverty is rooted in low salaries, discrimination and a lack of jobs due to social injustices. Poverty is the result of mistakes in political decisions. The poor lack the ability to obtain stable and better paid employment due to low qualifications. A great deal of unqualified work has become redundant due to technical advancement and unemployment increases.
2. Poverty as a result of laziness, intemperance and wastefulness of individuals - poverty as a result of individual deficiencies, their amorality, which can be eliminated by re-socialisation, education, investments in human capital, discipline, control and new attitudes.
3. Poverty as a consequence of situational factors, such as misfortune, fate and “the culture of poverty” and “cycle of deprivation”. Poor people concentrate in a specific area where a subculture develops, which locks the poor into poverty and prevents them from extricating themselves. Unsuitable family environments and family upbringing negatively affect the value systems in children. In this type of “culture of poverty”, people learn how to live simply by surviving and see their surroundings as a normal state from which there is no path out. People are unwilling to work, to take responsibility for themselves, and are characterised by wastefulness, low morals, alcoholism and irresponsible parenting.



With regards to the randomness of life, poverty is the result of a lack of luck or consequence of misfortune or a necessary tax on the progress of society.

People in society accept solidarity with people who are unable to take care of themselves for objective reasons. A typology with four basic types of explanations is currently used in the assessment and analysis of opinions on the causes of poverty and these connect the causes of poverty to:

1. poverty as the failure of an individual,
2. poverty as the fate of an individual,
3. poverty as the failure of society,
4. poverty as the fate of society.

Two dimensions are apparent in this typology, the first of “the individual versus society” connects to the internal disposition of an individual (negative traits, such as laziness, alcoholism, speculativeness) or to the outside, what is society in this case (the poor as victims of external circumstances, the unfair distribution of resources, the stigmatisation of the poor by society). The second is the juxtaposing of “failure versus fate”, where failure is related to the conviction that an individual is able to influence their situation but fails to take sufficient action and conversely, fate, which speaks to a confluence of circumstances with a negative effect on the individual that are impossible to change or influence. In simple terms, they may be designed as internal vs. external and controllable vs. uncontrollable. (Strapcová, 2004). A survey conducted in 1999 involving 1283 respondents in Slovakia generated results whereby 37.6% of respondents identified the unjustness of society as the cause of poverty, while 31.3% identified laziness or a lack of will. The survey does not clearly define what the respondents mean under the term “unjustness”, for instance low salaries, discrimination or a country’s tax policy. (Strapcová, 2004). The definition of the causes of poverty may build on the dimensions and indicators of social exclusion, which Janie Percy-Smith (2000) defines as follows:

- economic dimension - volatility of work, long-term unemployment, income poverty, households without an employed member;
- social dimension - homelessness, unwanted pregnancies, the collapse of the traditional family, delinquency, criminality;
- political dimension - low community activity, low participation, lack of political rights, low participation in elections, social disorder;
- community dimension - unavailability of social services, collapse of supporting networks, devastation of the environment and dwellings;
- individual dimension - low education, insufficient qualifications, disease, handicap, lack of self-confidence and self-esteem;
- spatial dimension - concentration, marginalisation of the excluded in areas with risk factors, including crime, usury, prostitution, incest, insufficient infrastructure, difficult access to healthcare and schools.

The causes of poverty may be examined in terms of the factors that most often cause poverty, which according to Ružička (2008) include head-of-household education, standing on the labour market, the location of a household, the demographic composition of the household and ethnicity, especially Roma. Another cause of poverty, globalisation, may be added to the factors identified by the authors as it is responsible for a loss of jobs in industry and in agriculture, two sectors where people with lower levels of education found work. Low-skilled people have lost their jobs and fallen into the social safety net. There are two sides to the opening up of a labour market. One is that it permits our nationals to find employment abroad, while the other, negative aspect is that it allows a wave of cheap labour in from Ukraine and Romania, which

entrepreneurs use to inflate profits by exploiting their willingness to work for lower salaries. Low-cost countries, such as China, India and Brazil, are excelling on the global market, while Slovak companies are unable to compete, which leads to their dissolution, the redundancy of their employees in Slovakia and the loss of jobs.

#### **4. POVERTY IN SLOVAKIA**

Slovakia began to see the signs of poverty after the collapse of the communist regime in 1989. Previously, social security had been provided in the spirit of socialist ideology based on collectivisation (Oláh, Iglárová, 2015). The system gave priority to the collective care for socially disadvantaged children, the disabled and the elderly. The flaw in this system is that those dependent on assistance were pushed to the fringes of society, cutting them off from majority society, and essentially depriving them of the rights to personal freedom, self-determination and independence. Disabled children did not grow up with their parents and healthy siblings; rather they were institutionalised in health institutions. Absolute poverty had been completely wiped out in Czechoslovakia, as it contravened socialist ideology, which was based on equality among people. Halušková, Božik (2015) note the 0% unemployment rate in the former Czechoslovakia, where “housewife” was essentially the only permitted form of unemployment. The artificial maintenance of employment was a deficiency of the system and led to a decrease in the overall standard of living. The opening up to new financial, political, social and economic conditions in a closed society as was our country led to the degradation of the social situation attributable to an inability to adapt to the changes in the system. The increased incidence of socio-pathological phenomena and people falling into poverty was observed. (Oláh, Iglárová, 2015). Changes in the political system were reflected in social systems, where state paternalism was replaced by a new system based on the co-responsibility of citizens for their social situation. The instability of the social system itself was expressed in rising unemployment, homelessness, poverty and insufficient pension security, which proved the impetus for the state to develop three separate systems focused on stabilising the social situation. Changes involved social insurance, state social benefits and social assistance. (Oláh, Iglárová, 2015). The concepts of poverty based on external transparency in Slovakia are perceived as visible and hidden poverty. Homelessness, with its characteristic traits such as living on the streets, lack of hygiene, and dirty clothing, represents visible poverty. (Demek, 2011). Some authors call hidden poverty “unreported poverty”. Those who experience this form of poverty include the homeless, Roma, young people released from children’s homes and individuals released from custody who are unable to claim social benefits, due to a low-level of legal awareness or an inability to apply their own rights and entitlements. Individuals in many instances have no interest in assistance. This “invisible poverty” must be perceived and resolved because it is the most visible and most obvious kind of poverty that takes the form of absolute, extreme poverty. (Džambazovič, 2007). Authors automatically classify homelessness as both visible poverty and hidden poverty. The reason is the simple visibility of homelessness, while the homeless in many cases are unaware of their rights, unable to request assistance and therefore simply don’t exist to authorities. Primary and secondary poverty in Slovakia are discussed in relation to income. Primary poverty refers to the lack of resources to cover the subsistence minimum. (Kozubík, 2011). Secondary poverty stems from the inability of the household to reasonably manage the funds at its disposal. Repeated indebtedness, for instance, when not paying rent, which exposes a family to eviction from their flat, increases the risk of secondary poverty. (Demek, 2011). A person is considered to be in poverty in Slovakia when they are in a state of material need, household income is less than the subsistence minimum and the members of the household are unable or cannot secure or otherwise increase their income. The subsistence minimum is the socially recognized minimum income threshold of a natural person below which a state of material need arises.

## 5. CONCLUSION

Slovakia is included in the club of elite and the most advanced countries, despite the fact that 12.3% of the population, or 640,000 people in Slovakia were at risk of poverty in 2015, with the unemployed representing 45.7%, households with three and more dependent children 32.9% and single parents with at least once child 29.7% of this group. About 640,000 people were at risk of poverty in Slovakia in 2016. Poverty reduction is one of the long-term priorities of public policies in Slovakia. Governments must also adopt social inclusion measures that are more focused on active inclusion, monitoring and policy evaluation.

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## REGIONAL DISPARITIES IN THE SLOVAK REPUBLIC

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### ABSTRACT

*The issue of regional disparities within the European Union has come to attention, especially after the largest enlargement in 2004, following the accession of relatively economically less developed countries, including Slovakia. The development of economic, social and geographical inequalities is an important subject of society's interest. In the context of theory, two fundamental tendencies are related, in particular, to the role of the state in mitigating regional disparities. The first approach is based on the assumption that there are forces in the long run leading to balancing regional disparities and therefore the state should not interfere significantly. The second approach inversely highlights the role of the state in reducing regional disparities and thus supports the development of regional policy as a set of tools for economic and social cohesion. Differences in economic development and its dynamics, economic activity, the level of living, the level of unemployment, and the level of wage vary between regions. There is a tight link between wage levels and unemployment, the nature of which is the subject of frequent expert discussions. Both unemployment and wage rates show a considerable degree of regional differentiation in Slovakia, especially between the capital Bratislava and other regions of Slovakia, which is related to the status of the capital as an economically dominant region and, on the contrary, to the economic challenges of lagging regions, especially in Central and Eastern Slovakia. Monitoring regional disparities enables the less developed regions of a particular region to be targeted by regional aid. Regional development in Slovakia is largely provided through EU funds. Investment incentives also play an important role as one of the tools to motivate investors to place their new branch offices mainly in less developed regions, in areas with higher levels of unemployment. The main objective of the contribution, based on the analysis of the current situation of the labour market situation and wage inequalities, is to identify the impact of the main factors on the phenomena examined, i.e. unemployment and wage differences.*

**Keywords:** *Regional disparities, Regional policy, Unemployment, Wage differences*

### 1. INTRODUCTION

The issue of regional disparities within the EU has come to the forefront, especially after its largest expansion in 2004, during which relatively less economically developed countries joined the EU, including Slovakia. The increase in regional disparities corresponds to the different economic conditions, the ability to restructure and the overall capacities of the regions themselves. The lagging behind of peripheral regions triggers a spiral and underpins their further marginalisation. Regional disparities in Slovakia have proven to be a persistent problem, despite higher GDP growth. According to Kvetan and Domonkos (2009): “The level of regional development must be seen as the sum of economic indicators and the indicators of the social situation, i.e. those indicators that describe the general quality of life”. The social and economic level of the regions in Slovakia has come to the forefront, especially in terms of

perceiving the differences between regions, and is a frequently discussed question. The most obvious differences are between the Bratislava Region and other regions, especially in Central and Eastern Slovakia. This contribution focuses on identifying regional disparities and the cause of their occurrence with an accent on unemployment and salary differences in Slovakia's regions.

## **2. REGIONAL DEVELOPMENT AND REGIONAL DISPARITIES IN SLOVAKIA**

The monitoring of regional disparities permits the definition of the less-developed regions into a particular group into which regional development must be directed. Regional development opportunities are mostly concerned with economic concepts that connect a solution to a particular issue with economic growth. Regional development in Slovakia is supported through funding, the majority of which is drawn from the EU. In the past, pre-accession funding was provided to prepare the associated countries for entry into the EU. A new legislative framework was submitted in the 2014-2020 programme period for a total of five funds under the EU's Cohesion Policy, Common Agricultural Policy and Common Fisheries Policy. These are the five European Structural and Investment Funds:

- European Regional Development Fund (ERDF);
- European Social Fund (ESF);
- Cohesion Fund;
- European Agricultural Fund for Rural Development (EAFRD);
- European Maritime and Fisheries Fund (EMFF).

The reform introduced two key objectives for cohesion policy:

- Investments into growth and job creation, which is a common objective for all three categories of regions: less developed, transition, and more developed (supported from the ERDF, ESF and Cohesion Fund);
- European territorial cooperation to be supported by the ERDF.

A suitable institutional and legislative environment is the critical prerequisite for securing regional development. Institutional assurance includes state support for the establishment and development of institutions focused on the promotion of regional development and regional policy. In a general sense, the term disparity represents inequality, diversity or disproportion of different phenomena. A number of perspectives help provide better understanding of this specific term. With emphasis on the importance of the time and spatial dimensions of regional differences and the need to understand the level at which individual regions lag behind, it can be said that regional disparities mean “differences, inequality of features, phenomena or processes, the identification and comparison of which has a rational meaning” (Švecová, Rajčáková, 2014). Regional disparities may be examined as “unjustified differences or inconsistencies between the potential of a particular phenomenon and its current use”. These disparities are most intensively perceived in society within the general context of divergence or convergence at the level of individual regions (Viturka a kol., 2010). The development of social and geographical inequalities is undoubtedly an important subject of study of society as it is a manifestation of its hierarchical organization. Differences may be a source of social and political tension and may compromise the stability or ecological balance of the society (Švecová, Rajčáková, 2014). Disparities as a manifestation of imbalanced development may occur as a result of the exhaustion of the territorial capital in any of the pillars of sustainable development in one territory. The risk that imbalanced development leads to disparities may also occur inside the individual pillars by reducing diversity, for instance with the development of a single economic activity and the concurrent loss or stagnation of all other activities or growing differences between the standard of living among different social groups in the area.

Disparity in an area is manifested by significant differences in the quality of public services or public areas in different parts of a city or region. Disparity is most often caused by the exploitation of a specific resource in the area at the expense of other resources and values in the area. Such imbalanced and excessive usage is often accompanied by the export of benefits from the territorial capital to outside its own territory. The spatial aspect of sustainable development is apparent in these cases. The end result of imbalanced and disparate development in an area is an increase in the differences between the quality of life in individual areas or among inhabitants (Maier, 2012). The causes of regional differences may be divided into internal and external causes. Internal causes are sourced from the regional development actors in the given area, including their conduct, habits, motivations, capabilities and their usage. External causes are understood as societal conditions and different environments. Because of the dominance of socio-economic processes, differences are formed and gradually increase on a constant basis in the modern age. But we cannot say that the existence of differences has inherently only negative impacts on regions. To a certain extent, we may consider them an important motivating impulse to mobilise internal resources in the region or a prerequisite for a more efficient division of labour or specialisation of the regions going forward (Krejčí et al., 2010). In local conditions, social differences between and within regions are greater than economic differences. The framework of values in society is primarily focused on solidarity and equal opportunities, employment growth and assisting marginalised groups. Slovakia is characterised by distinct regional diversity with a differentiated spatial distribution of production forces, differentiated economic infrastructure, different levels of urbanisation, and different human potential, which results in uneven socio-economic development of the individual regions (Rievajová et al., 2012). Despite the fact that data on regional levels of unemployment show significant differences between regions, the regional differences within a single country are more significant than the differences between other countries. A specific trait of regional unemployment is its causal dependence on space. This means that if unemployment only exists in a single specific region, then this is in a causal relationship with the neighbouring regions. The causal dependency can be observed in the conduct of companies, where firms do not limit themselves to the resident labour force at their present location; rather they use the labour force from the neighbouring region with higher unemployment, as often this labour is less expensive as well (Rievajová et al., 2015). Among the major causes of uneven development of the regions and the emergence of regional disparities in the past in Slovakia include:

- A severe decline in production and employment in heavy industry (coal mining, metallurgy, mechanical engineering and chemicals), which was the dominant factor, and remains a major part of the economic structure in specific regions (Košice, Žilina and Trenčín Regions).
- A slowdown in the textile and electronics industries had a serious impact on the economy and employment, while declines in the clothing and shoe industries affected employment (Prešov, Košice and Trenčín Regions).
- A decrease in the number of people working in agriculture, which had a relatively high share of economic output in mountainous, sub-mountainous and lowland areas (Nitra, Banská Bystrica and Košice Regions).
- The development of the tertiary sector largely concentrated itself in large cities absorbing a significant portion of workers made redundant in inefficient manufacturing companies.
- Imbalanced development of small and medium enterprises did not create a sufficiently strong sector focused on the production of tangible goods and industrial services.
- Quality of human resources (education and entrepreneurial tradition) and local authorities (conceptual approaches and strategic planning).
- Territorial infrastructure and the absence of a comprehensive approach to the revitalisation of settlements.

- An incomplete network of motorways and dual carriageways slowing transport and forming barriers to access to certain regions.
- Poor labour force mobility between regions connected with limitations on finding housing near work and poor access to public transport, with particular negative effects in areas with low population density and with greater distances between towns.
- Unsatisfactory state of the environment in areas with an unfavourable industrial structure.
- The occurrence of a large number of territorial and technical specificities and the difficulties affecting regional development. These are primarily the result of the extraction of mineral resources, the great fragmentation of the landscape itself (mountainous and sub-mountainous areas), resulting in transport problems in terms of accessibility and the economic efficiency of the regions (NSRRSR, 2017).

Many of these causes remain in place today. Member states of the European Union use a system of classification of territorial units for statistics known by the acronym NUTS (from the French name *Nomenclature des Unites Territoriales Statistiques*). This system was completed for the purposes of breaking down the territory of EU member states into territorial units at a lower hierarchical level than the national states themselves for the purposes of providing a territorial framework within regional statistics. NUTS classification of the regions is based on a five-level hierarchy of classification of regions, while three levels are regional (NUTS I to NUTS III) and two are used at the local level (NUTS IV (LAU I) and NUTS V (LAU 2)). For defining territorial units under this system, institutional allocation is preferred, serving, amongst other things, for the allocation of Structural Funds as a basic financial instrument of EU regional policy.

### **3. REGIONAL DIFFERENCES IN UNEMPLOYMENT AND SALARIES IN SLOVAKIA**

One opinion found in professional circles is that 3 to 4% unemployment is the ideal situation in a country. Three regions in Slovakia met this target in December 2017, the Bratislava, Trnava and Trenčín Regions. Another two regions, (Nitra and Žilina) just barely missed this arbitrary threshold by less than a full percentage point. The remaining three regions, Banská Bystrica, Prešov and Košice Regions, more than doubled the optimum rate of unemployment. In order to determine actual development, it is appropriate to focus on the recorded level of unemployment over the long-term. As is clear from Table 1, all the regions have recorded a decreasing trend in the recorded level of unemployment over the long-term. The largest decreases over the monitored period were recorded in the Prešov Region (9.39 percentage points) and in the Banská Bystrica Region (9.31 percentage points). The national average was a decrease of 7.36 percentage points. The first five of the reported regions report unemployment that is lower than the national average: Bratislava, Trnava, Trenčín, Nitra and Žilina Regions. Unemployment in the other regions (Banská Bystrica, Prešov and Košice Regions) is higher than the average in Slovakia. The reason for low unemployment in the Bratislava Region is the fact that most enterprises and companies operating across the broadest range of industries have their head offices there. A large quantity of enterprises with high added value are also concentrated there and the region functions as the technological leader in Slovakia. One of the lowest rates of unemployment is connected to the highest salaries.

*Table following on the next page*

*Table 1: Development in the recorded level of unemployment by NUTS III regions, 2013 to 2017 (own work using Office of Labour, Social Affairs and Family data)*

Area/year	2013	2014	2015	2016	10/2017	Difference 2013/2017
<b>Bratislava Region</b>	6.17	6.13	5.34	4.51	3.33	2.84
<b>Trnava Region</b>	9.16	8.03	6.71	4.41	2.75	6.41
<b>Trenčín Region</b>	10.74	9.56	7.71	5.85	3.60	7.14
<b>Nitra Region</b>	12.52	11.21	9.71	6.96	4.27	8.25
<b>Žilina Region</b>	12.51	10.91	8.86	6.92	4.81	7.70
<b>Banská Bystrica Region</b>	18.26	17.22	14.94	12.80	8.95	9.31
<b>Prešov Region</b>	19.35	17.45	15.50	13.91	9.96	9.39
<b>Košice Region</b>	17.23	15.92	14.39	12.76	10.10	7.13
<i>Slovakia</i>	<i>13.50</i>	<i>12.29</i>	<i>10.63</i>	<i>8.76</i>	<i>6.14</i>	<i>7.36</i>

There is a direct proportion between level of education and the ability to find employment. A suitable example is that there are 25 job-seekers who have not completed the primary education in the Bratislava Region, while there are 5,146 job-seekers in the same situation in the Prešov Region. Members of the Roma community account for a preponderance in this group, and record high levels of unemployment and very low economic activity in addition to low levels of education.

*Table 2: Average gross salary by region in € per month, 2017 (Statistical Office of the Slovak Republic)*

SR	BA	TT	NR	TN	ZA	BB	PO	KE
954	1200	890	789	895	855	807	734	869

*Notes: SR - Slovakia, BA - Bratislava, TT - Trnava, NR - Nitra, TN - Trenčín, ZA - Žilina, BB - Banská Bystrica, PO - Prešov, KE - Košice*

The average gross salary in Slovakia in the final quarter of 2017 exceeded €1,000 for the first time ever, representing a year-on-year increase of 5.2%. However, this threshold was only exceeded in two of the eight regions, the Bratislava and Trenčín Regions. Overall data for the previous year shows persistent regional differences, with the average salary in Bratislava around 25% higher than the national average. This situation is similar to many EU countries. The average salary in the Prešov Region is only 77% of the average in Slovakia; when compared to Czech Republic, the lowest average salary is reported in the Karlovy Vary Region, which was 87% of the national average. In a year-on-year comparison of average salaries using data from the Statistical Office of the Slovak Republic, salaries increased the most in the Trnava and Trenčín Regions, which was the result of functioning businesses and expansion of production at the Peugeot automotive plant in Trnava and multiple logistics-based investments. Similar development can be expected in the Nitra Region once production gets under way at the Jaguar plant. Nominal salary growth in 2018 should reach ~5%, with growth of 4.6% in 2017. Average salary growth has also been driven by the current labour shortage on the Slovak labour market. Compared to developed EU countries, real salaries in Slovakia continue to be among the lowest, despite this growth.



#### 4. CONCLUSION

In periods of economic transformation, including in Slovakia, significant differences remain between regions due to differences in economic, technical, demographic and other potencies in connection with geographical circumstances. These characteristics conditioned a wave of foreign investment, which further deepened the differentiation of the regions. This created a central area, the capital and its nearby environs, as the main pole of development, and a periphery, especially the more remote areas in Central and Eastern Slovakia and its southern districts overall. The problems facing underdeveloped regions include insufficient infrastructure, poor connections to major transport routes and a stronger focus on agriculture. Differences appear in basic infrastructure and advanced infrastructure (transport and telecommunications) as well as in research and development, and in labour force skills. In the EU, this is one of the main policy objectives - to remove significant regional differences, with a focus on cohesion policy. Its means are used as direct resources to suppress specific differences between regions. A key issue remains the optimum rate of regional disparities in line with the general objective of maximizing social well-being.

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## USING THE RISK-LIST METHOD FOR RISK ASSESSMENT IN THE PROJECT

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### ABSTRACT

*Each action undertaken by a human being is accompanied by risk, it also refers to actions with unrepeatable character, such as projects. Projects as such are perceived as enterprises of unique character, referring to future solutions, the results of which may differ from accepted assumptions and goals in the project. In order to restrict the occurrence of events risking the reaching of the goal and positive benefits arising from effective implementation of projects is a need for identification of risk and its management. It is worth emphasizing that in practice, despite the occurrence of various kinds of risk the projects are implemented. However, the risk assessment in the project is a basis for managers to undertake decisions on its implementation or abandonment. Various methods may be used for risk assessment in the project. The goal of the article is the emphasizing of significance of risk identification in the project as a significant element of effective management of the project. Moreover, the risk-list method expanded by the author serving for risk assessment was presented. In the article the following thesis was presented: identification and risk assessment in the project contributes to effective implementation of the project and for achievement of the planned results.*

**Keywords:** Project, Risk, Risk assessment, Risk-list method

### 1. INTRODUCTION

Risk is a category of interdisciplinary character, which occurs in all areas of human activity, therefore the natural need is identification, measurement and risk management. Scientific approach to risk assessment arose from the events which took place in history and its real impact on contemporary political, economic, social, cultural changes as well as technical progress. Arising and scientific development of a discipline called Risk Management was launched in 1921 by F. Knight, which drew the attention to differentiation of two ideas, namely uncertainty and risk. F. Knight in his fundamental work titled *Uncertainty and Profit*, separated the non-measurable *sensu stricto* uncertainty from measurable uncertainty, i.e. risk (Knight, 2006; De Meyer, Loch, Pich, 2002). Moreover, he emphasized that the uncertainty is connected with unpredictability, therefore it refers to situations in which there is no full information regarding the probability of the occurrence of an event, as well as effects of its occurrence. It means that the risk may be referred to known events or events which can be known, the probability of which of effects of occurrence may be estimated. F. Knight began the scientific discourse regarding the risk, which is continued in the scope of various scientific disciplines. In the scope of discipline of management, especially in its practical aspect, the risk is the key factor which has impact on effects of undertaken activities and developmental potential of organizations (Koziene, 2017). Risk may be defined as combination of probability of occurrence of an event and its effects (ISO IEC Guide 73:2002, 2002). This general definition of risk is made more precise in two concepts singled out in the pertinent literature, and namely negative and neutral. Negative concept identifies the risk only with the danger, damage, loss (Wilson, 2005). However, the neutral concept is based on the assumption that risk is neither a negative nor positive phenomenon (Jajuga, 2007). It straightforwardly assumes that the occurrence of risk will cause such a situation the expected result of the activity will be different that the expected

one (Kaczmarek, 2002). In practice of management in the scope of identification and risk assessment, one may notice a fragmentary approach referring to selected areas (Bannister, Bawcutt, 1981, Kloman, 1992) and the holistic approach identifying the collection of potential risks for the entire organization (Bromiley, McShane, Nair, Rustambekov, 2015). In the article the analysis concerning the issues of risk were restricted to the actions implemented in a form of projects. What is a project then? As the American Project Management Institute (PMI) states, the project is a „temporary enterprise undertaken in order to create a unique product or service”(PMI, 2008). This short definition contains two primary characteristics of a project, namely:

1. Temporariness – referring to a period of time of project implementation, which varies as to the length of its duration, as well as to the establishment of a date of commencement and foreseen date of the end of its implementation;
2. Uniqueness – connected with a result of a project, which is unrepeatable or specific due to certain characteristics.

Coming to a problem of risk assessment in the project one may notice that it is most frequently referred to a failure to meet the planned deadline, budget, quality and results, what the occurrence of risk has a factual impact on. European Commission explains the risk of the project as a probability of occurrence of an action which can have positive or negative effects for implementation of a part or for the entire project (Project Cycle Management Guidelines, 2004). The essential characteristics of risk is a possibility of its identification and measurement using methods. The purpose of the article is the emphasis of identification of risk in the project as significant element of effective risk management. Moreover, the method of risk-list expanded by the author serving for its assessment was presented. In the article the following thesis was formed: identification and risk assessment in the project contributes to its effective implementation and reaching the planned results.

## **2. RISK ASSESMENT IN THE PROJECT USING THE RISK-LIST METHOD**

Every person assesses other people as well as the activities (projects) undertaken by them, as well as effects of these actions. These estimations have a character of estimation of a part or of entire action (project). Due to the differentiation of persons and forms of activity one-or multi-criteria schemes of estimation are created. Therefore, what does such a notion as „estimation” refer to? Estimation (Latin: *aestimatio*) means value or valuation, assessment of something and is of valuating nature referred to as norms, approved and effective standards, as well as specimen system of estimations. A definition of a notion of „estimation” formed this way requires making an object of estimation or subject of estimation more precise, as well as specification and definition of quantity and/or quality criteria of their estimation. The key issue of risk assessment in the project is also a moment of making the assessment. In the project one may assess the risk:

- Ex ante, which means the anticipation of probability and effects of risk occurrence in the scope of selected areas of project implementation. Estimation is conducted at an initial stage of project preparation, therefore in a phase of an idea and planning,
- On-line, refers to current monitoring of risks assessed in the project and identification of new risks, which had not been envisaged in an initial phase but occurred in a project implementation phase.

The ex-ante and on-line estimation of the risk in the project has impact on the complete estimation of effective implementation of the project due to the purpose, time, cost, quality and strategic and social effects. The benefit of the ex-ante and on-line estimation of risk in the project is a possibility of performing an adjustment of basic parameters of the project, what is

difficult but possible, however, in a phase of closing the project it becomes unfeasible. Apart from the specification of a method of risk assessment in the project also a choice of a method for its estimation is essential. One of the interesting approaches to the quantitative estimation of risk in the project is a method proposed by Bradley (Bradley, 2003). The basis of complete estimation which is performed by designation of a value of total project risk coefficient  $RP$  in the Bradley approach is giving an answer to 40 criteria ( $i=1,2,...,N$ ;  $N=40$ ) assessed by quoting the risk assessment for a single criterium  $r_i$  in a scale from zero to four in a discrete manner, referring to natural numbers. Criteria refer to six areas: project management, personnel participating in the project, character of the project, maturity of organization, clients and contract, suppliers. Bradley orders the approval of applicable weight for each of the criteria  $w_i$ , at the same time proposing the scope of variability of value of these weights. In such a formulation the value of total project risk coefficient  $RP$  is designated according to a formula (1).

$$RP = \frac{\sum_{i=1}^N w_i r_i}{\sum_{i=1}^N w_i} \quad (1)$$

The appointed value of total project risk coefficient  $RP$  is a basis for classification of a project as a project with: (Bradley, 2003):

- low risk – for the value of resulting coefficient below 2.0;
- moderate risk - for the value of resulting coefficient from the division [2.0, 2.2];
- high risk - for the value of resulting coefficient from the division [2.2, 2.6];
- very high risk - for the value of resulting coefficient above 2.6.

The project risk assessment method formulated this way does not make it possible to identify the risk in particular areas, but the value of each of the criteriums is weighed only globally (a number of criteria in particular areas varies significantly). In order to avoid this inconvenience the generalization of Bradley's method was proposed, by introduction of identification of partial risk coefficients for singled out areas of project:  $RP_k$  ( $k=1,...,6$ ) and values of total project risk coefficient  $RP$ . In difference to Bradley's approach the weight coefficients are introduced for particular areas  $\alpha_k$ , leaving weight coefficients for each of the criteria, binding them at the same time with each area  $w_{ik}$ . Also, new formulations of criteria are suggested, restricting their number to 38 ( $N=38$ ) and defining the following number of them for considered six areas (instead of the area the project management, project milieu were introduced) :

- project milieu – 2 criteria ( $N_1=2$ );
- client and contract – 4 criteria ( $N_2=4$ );
- supplier – 6 criteria ( $N_3=6$ );
- maturity of organization – 4 criteria ( $N_4=4$ );
- characteristics of the project – 15 criteria ( $N_5=15$ );
- project team participating in the project – 7 criteria ( $N_6=7$ ).

Moreover, it was assumed, that the quoted value of estimation for each criterion  $w_{ik}$  may assume any values from the range [0,4]. With such assumptions the value of partial project risk coefficient  $RP_k$  for  $k$ -times area is designated from the formula (2), and the value of total project risk coefficient  $RP$  from the formula (3), as the weighted average from average partial risks. Also, the dependence (4) is maintained. Classification of total risk of project  $RP$  and partial risks  $RP_k$  is approved pursuant to the Bradley's proposal described above.

$$RP_k = \frac{\sum_{i=1}^{N_k} w_{ik} r_i}{\sum_{i=1}^{N_k} w_{ik}} \quad (2)$$

$$RP = \frac{\sum_{k=1}^6 \alpha_k RP_k}{\sum_{k=1}^6 \alpha_k} \quad (3)$$

$$\sum_{k=1}^6 N_k = N \quad (4)$$

The suggested modification of the method makes it possible to expand it by:

- taking into account of additional areas,
- changing a number of criteria in particular areas,
- changing of values of weights for areas,
- accepting other borderline values for interpretation of this type of risk.

In the quantization proposed by Bradley (Bradley, 2003) the value: two was accepted as neutral value of risk. The lower borderline value of low risk is zero, and the upper value of high risk is - four. The division of values from one to three means the risk „within the norm”. In the method there are thirty eight risk factors, formed descriptively and including various areas which have impact on implementation of the project. Risk assessment for each factor is made subjectively by quoting the values of parameters of descriptive analysis of risk  $r_i$ ,  $i=1,...,N$  ( $N=38$ ), which accept values from zero to four with the comment quoted above. The considered factors have various impact on implementation of the project. Therefore, the weight coefficients of factors  $w_{ik}$ ,  $i=1,...,N$  ( $N=38$ ),  $k=1,...,6$  are introduced by quoting subjective values of significance of a factor for a given project among the division of values quoted in the risk list.

The appointed value of project risk coefficient  $RP$  is a basis for classification of a project pursuant to the risk assessment in the project, presented above, according to Bradley (1) (Bradley, 2003). Method for risk assessment in the project was called the risk-list method. Assuming that identification and risk management is a continuous process one may draw up lists of project list assessment in two moments of its measurement ex ante and on-line, respectively. The risk list method was applied for risk assessment in the manufacturing project, concerning the process of manufacturing of trailers and semitrailers. Risk assessment in the analyzed project was made ex ante i.e. at the stage of preparation of a manufacturing project for implementation in a company. In table 1 the risk assessment was performed ex ante according to the criteria taken into account in the „risk list” method, whereas in table 2 the partial results for six areas of risk in the project were presented as well as the total risk assessment ex ante in the project.

*Table following on the next page*

*Table 1: Criteria or risk assessment ex ante in the „risk list” method for the manufacturing project (own study)*

No. /i/	DESCRIPTIVE RISK ASSESSMENT /r/		VALUE	COEFFICIENT OF SIGNIFICANCE OF A CRITERION	
	LOW RISK / r <sub>i</sub> =0/	HIGH RISK / r <sub>i</sub> =4/		SCOPE	VALUE
PROJECT MILIEU					
1.	Foreseeable changes occurring in the project milieu	Unforeseeable significant changes occurring in the project milieu	3	6-8	7
2.	Involvement and positive impact of external stakeholders (extra- and intra-organizational) and internal	No involvement or positive impact of external stakeholders (extra- and intra-organizational) and internal	2	4-7	7
CLIENT AND CONTRACT					
3.	Client shows full understanding of requirements and their impact	The client shows weak understanding of significance of requirements	2	4-7	5
4.	No changes or only slight changes will be necessary in the client's current solutions	Vast changes were envisaged in client's current solutions	1	3-6	3
5.	Formal conditions are agreed upon in the contract	No formal contract was concluded	1	4-7	4
6.	In the past there were contacts with the client and current contracts were performer successfully	In the past there were problems with the client and previous contracts	1	3-6	3
SUPPLIERS					
7.	Suppliers are known and acknowledged and they have good references	New, unverified suppliers and not much is known about them	2	4-8	4
8.	Only one solid ad verified supplier	Many suppliers and sub-suppliers are envisaged	2	3-6	2
9.	Supplier has a project management system based on PRINCE2 or related program	Organization of supplier's project management is interim and defined to a small degree	4	3-6	4
10.	There is a contract with a supplier	Only informal arrangement is concluded	1	4-7	4
11.	Head supplier has a quality management system based on ISO9001	Supplier does not have the quality management system	2	4-7	7
12.	Professional work is expected from the supplier	It is not possible to assess a supplier's future work on account of the lack of information	2	3-6	4
MATURITY OF ORGANIZATION					
13.	There is a managerial and organizational system assisting project management	There is no managerial and organizational system assisting project management	2	4-7	4
14.	Management practices the commonly applied human resources management standards	No defined human resources management standards	2	3-6	3
15.	Project staff applies management standards (methods and methodologies)	Project staff does not apply any existing project management standards	2	4-7	5
16.	Comprehensive system of knowledge management (knowledge base)	No standards of knowledge management	2	6-8	7
PROJECT CHARACTERISTICS					
17.	Requirements are or will be well specified and documented by the client	Requirements are badly defined by the client and they are not documented	2	3-6	3
18.	Typical project with a single lifecycle	May co-dependent project lifecycles	2	4-6	4
19.	Final produkt is without or with a small number of novelty functions	Pioneer solutions are tested in the project	3	6-8	7
20.	Equipment installed within the project is well-known and tested	Equipment is not verified, its use unreliable	2	4-6	4
21.	Current, main operations to a small degree	Significant impact of the project on current and main operations	2	3-5	4
22.	There will not be a need of large changes in existing technical standards	Significant changes of exisiting technical standards will be required	3	3-6	5
23.	Concurrently a small number of R&D works are being conducted	Other R&D works are being conducted concurrently with the project	2	3-6	4
24.	Slight dependence on developmental devices being beyond control of project team.	High dependence on developmental tools being beyond control of project team	3	3-7	6
25.	Slight restrictions or the lack of restrictions regarding the date of completion of the project	Client specified the effective and valid date of completion of the project	1	4-7	5
26.	Plans and estimates are or will be based on reliable data from similar projects	Plans and estimates are based or will be based on unreliable data	2	4-7	4
27.	Estimates are prepared according to verified, documented standards	Estimates were prepared according to unverified standards	3	4-7	5
28.	This is the first or second approach to the project – no earlier failures	There have been already several attempts to work upon this project – there is a history of failures	2	4-8	5
29.	Only several departments of client's organization will feel the final results of the project	Many departments of client's organziation will feel the final results of the project	1	4-6	4
30.	Implementation of the project will have only small impact on everyday activity of the client	Implementation of the project will have significant impact on everyday activity of the client	2	3-6	4
31.	Developed and understandable project management standards are available to the project team	Few project management standards are available to project team	3	4-7	6
PARTICIPATING PROJECT TEAM					
32.	Anticipated readiness of the project team and client's for cooperation	Anticipated low involvement of the project team and the client's into the project	2	3-6	5
33.	High quality of project team, knowledge, experience and competences which are compliant with project requirements	Unexperienced project team without appropriate skills specified by the project scope	3	6-8	8
34.	Project team performs tasks connected only with the project	Project team performs tasks connected not only with the project	3	3-6	5
35.	Low rotation of team members, participation of experts	Frequent changes of team members arising from their incompetence	1	4-7	6
36.	Building project culture based on trust	No need to create project culture	2	4-7	6
37.	Effective system of information exchange and among project stakeholders	Problems with the system of information exchange and knowledge among project stakeholders	3	5-8	8
38.	Creative character of conflicts	Destructive multidimensional character of conflicts making the implementation of project impossible	3	4-8	7

Table 2: Partial and complete assessment of risk assessment *ex ante* with „risk list” method of manufacturing project (own study)

No.	AREAS OF PROJECT RISK	COEFFICIENT VALUE	RISK ASSESSMENT
PARTIAL RISKS			
1.	Project milieu	2.50	high risk
2.	Client and contract	1.33	low risk
3.	Suppliers	2,16	moderate risk
4.	Maturity of the organization	2.0	moderate risk
5.	Project characteristics	2,29	high risk
6.	Project team	2.49	high risk
COMPLETE ASSESSMENT			
Complete project risk assessment		2.13	moderate risk

Total risk assessment *ex ante* of manufacturing project made using the risk-list method was estimated at the moderate level ( $RP=2.13$ ), what was taken into consideration in a process of making a positive decision of management on access to project implementation in a company. The risk will be monitored in a special way in the scope of project milieu area ( $RP_1=2.50$ ), project characteristics ( $RP_5=2.29$ ) and project team participating in project implementation ( $RP_6=2.49$ ) due to the high estimate of its level. Choice of active (pre-emptive) approach for risk identification and assessment *ex ante* of the manufacturing project and its monitoring, i.e. making risk assessment *on-line* should both in the complete as well as partial risk assessment contribute to the success of its implementation. As a result of active approach applied to *ex ante* risk assessment in the project, as well as experience arising from prior implementation of similar manufacturing projects one may assume that the project will be efficiently implemented and a company will strengthen its competitive position.

### 3. CONCLUSIONS AND RECOMMENDATIONS OF SPECIFIC SOLUTIONS

Identification, analysis and risk assessment in the project is a key element of project management, making the undertaking of appropriate actions possible and providing permanent benefits arising from its effective implementation. Multiplanar assessment and risk analysis in the project pertains to various moments of its implementation (*ex ante*, *on-line*), and allows for use of active approach, i.e. preceding the occurrence of various kinds of risk in the project, but not reactive, being only a reply to materialized risk. The confirmation of significance of a problem of risk assessment and analysis is taking it into consideration in methodological management standards of project management, i.e. PMBoK®Guide methodology (A Guide to the Project Management Body of Knowledge 5th Edition, 2013) PRINCE2® methodology, (OGC, 2009) – which inspire to modification of current and searching for new methods of risk assessment. Suggested methods of risk-list serving for risk assessment in the project is the expansion of risk analysis method in the project according to Bradley (Bradley, 2003). Method of risk list is of universal character, what means that a number of areas of risk assessment in the project may be expanded similarly like a list of acknowledged criteria in particular areas, taking into account the specific character of the project. The advantage of this method is a possibility to assess the risk in project in two moments: *ex ante* and *on-line*. Moreover, the partial risk assessment in the project for particular areas makes it possible to take up appropriate measures and decisions aimed at effectiveness of project implementation and effectiveness in reaching goals and benefits arising from partial results of the project. Project manager may specify the strategy of proceeding in relations to identified risk in the project, i.e. take up a decision on its acceptance, avoidance, securing, transfer or reduction.

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## ACCOUNTING INFORMATION AS INDICATOR OF MONEY LAUNDERING

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### ABSTRACT

*The main aim of this research was to analyse which financial statements information can be used to deduce distinctive characteristics of companies involved in money laundering. Findings indicate several »red flags« which can potentially implicate fraudulent and unlawful activities. Some of these are significant increase of income while conducting such activities and decrease of income in years after, collaboration with fictitious companies which exist only to aid unlawful activities, using companies which are mostly small entrepreneurs and not subjected to rigorous regulations, internationality of operations usually exists etc. It is important to note that aforementioned »red flags« are more apparent and easier to detect when analysing financial statements of micro and small entrepreneurs, because medium and large entrepreneurs have large figures in their balance sheets and income statements, which is more suitable for camouflage. The process of auditing has not proved to be very effective in detecting accounting manipulations and unlawful activities related to money laundering. Presumptive reasons for aforementioned fact are absence of auditor's rotation and engaging audit firms which do not belong to »Big Four«. Considering lack of relevant and available information, inductive approach was optimal for this research given that it enables »in depth« analysis of financial statements in order to determine distinctive characteristics which can be basis for future researches.*

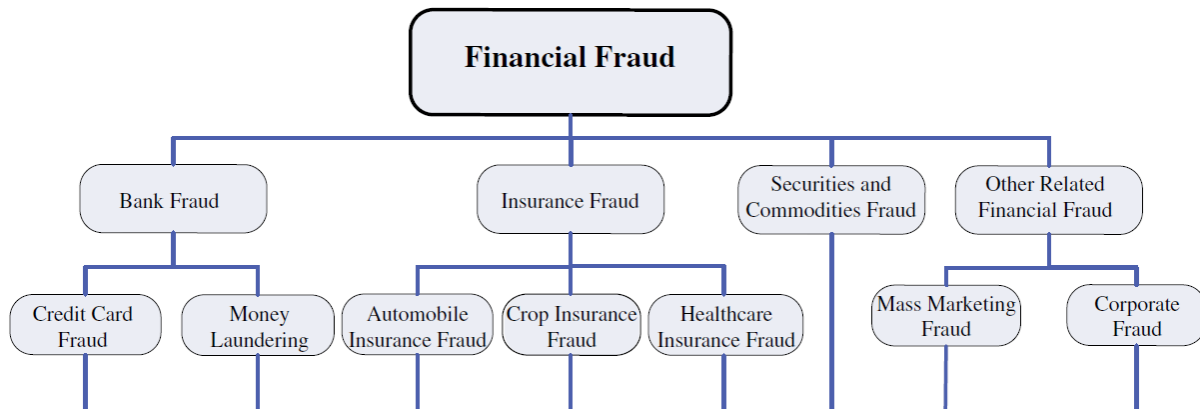
**Keywords:** *accounting, financial statemets, forensic accounting, fraud, money laundering*

### 1. INTRODUCTION

Money laundering is phenomenon with numerous detrimental effects which provides financial resources for serious criminal offenses such as terrorism and tax evasion (Takats, 2009). According to the Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, money laundering is regarded as „(a) the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action; (b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity; (c) the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity; (d) participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions

mentioned in the foregoing points” (European parliament and Council, 2005). Ngai et al. have classified money laundering as financial fraud and bank fraud (picture 1):

Figure 1. Classification of financial fraud



Source: Ngai, E. W. T., Hu, Y., Wong, Y. H., Chen, Y., Sun, X. (2011). *The application of data mining techniques in financial fraud detection: A classification framework and an academic review of literature*. *Decision Support Systems*, 50(3), 559-569.

Money laundering problem is intensively addressed worldwide, but the results are mainly disappointing because anti-money laundering measures usually impose burden to legal subjects which are not involved in such activities and they have to „pay for the prevention measures“ usually through involvement in time-consuming bureaucratic activities (Geiger, Wuensch, 2017). „As a common opinion, the current money laundering prevention framework fails to reach its own original goal, which is to reduce predicate offences“ because of „monetary and non-monetary costs of money laundering prevention for the society and ... small benefits“ (Geiger, Wuensch, 2017). Accordingly, „regulatory, law enforcement and reporting agencies need to respond to money laundering and terrorist-financing threats in ways that are proportionate to the risks involved“ (Ross and Hannan, 2007).

## 2. THE ROLE OF ACCOUNTING IN MONEY LAUNDERING

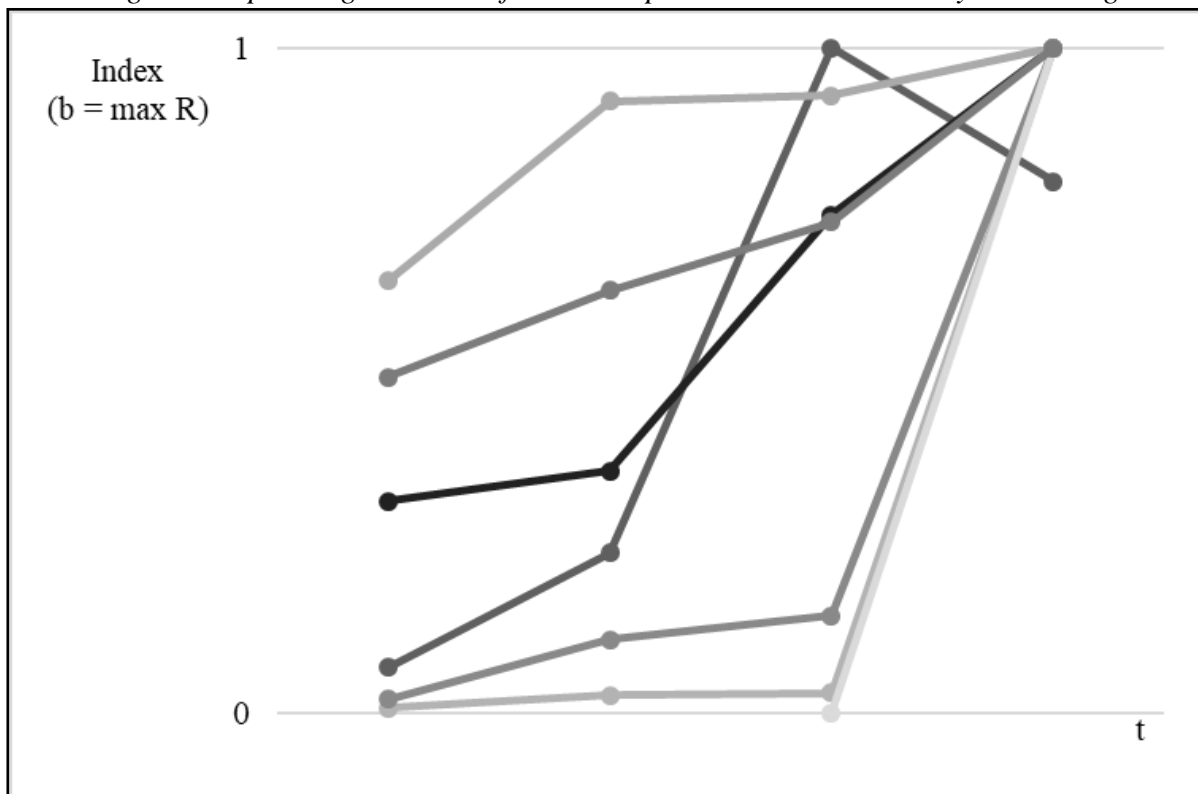
The role of accounting in money laundering can be two-sided. On the one side, accounting firms have the responsibility of combating against money laundering because of their expertise and insights in activities of a company which enable them to detect fraudulent and unlawful activities (He, 2010). On the other side, accounting can significantly facilitate financial crime by adding „a sophisticated edge to criminal operations“ (Compin, 2008), generating „a disconnection between the real sphere and the virtual economy“ (Compin, 2008) and using expertise „to create the complex webs of transactions whose purpose it is to conceal and obscure illegal activity“ (Mitchell, Sikka and Willmott, 1998). Inherent weakness of accounting lies in flexibility of International Financial Reporting Standards, which allows creative accounting and adjustment of information in financial statements which can mislead their users (Filipović, Bartulović, Filipović, 2018). Besides accounting skills, audit (internal and external) and forensic accounting skills are also indispensable for uncovering this type of crime (Mulig and Murphy Smith, 2008).

## 3. CHARACTERISTICS OF COMPANIES INVOLVED IN MONEY LAUNDERING

The main aim of this research was to analyse which financial and non-financial information can be used to deduce distinctive characteristics of companies involved in money laundering. Considering lack of relevant and available information and previous researches, inductive approach, with smaller research sample, was optimal for this research given that it enables in

depth analysis which can be basis for future researches. Companies involved in money laundering are predominantly classified as small entrepreneurs, with exception of some medium-sized companies which are used for unlawful activities despite the more strict requirements and control mechanisms within the meaning of greater transparency. In such cases, there is a disproportion between the value of income or property and value that company generates from money laundering, that is, the share of illegal activities is significantly lower. Consequentially, the detection of such activities by financial statement analysis is more complex. It should be noted that the audit of financial statements, as „mechanism of oversight and trust“ (Filipović, Bartulović, Filipović, 2018) did not prove to be highly effective in terms of detecting money laundering activities. But, it has to be highlighted that most of the companies in sample were small companies which don't have audit obligation. Melnik (2000) discusses possibility that „auditors are not very likely to report their clients' involvement in money laundering to the government because they fear that their relationships with their clients will be damaged“.

*Figure 2. Operating revenues of some companies involved in money laundering*



In most cases, it is possible to precisely determine the of period money laundering activities, from their start to end, using longitudinal analysis. Figure 1 shows typical patterns of operating revenue movement for companies involved in money laundering. Horizontal axis represents time lapse and vertical axis represents relative value of operating revenues. Relative value of operating revenues is calculated using maximal operating revenue for a company (which is in most cases the year of discovering money laundering activities, year before or year after that) as a base value. It is evident that smaller companies have had significantly intensive growth of operating revenues in comparison to larger companies. Pattern of operating revenues movement is obvious and it can be divided into three phases:

1. Reality phase,
2. Money laundering phase,
3. Discovery phase.

Reality phase refers to situation in which company's operating revenues faithfully represent their financial performance. Money laundering phase is characterised by intense growth of operating revenues as a consequence of unlawful activities. Discovery phase starts after money laundering activities are discovered by the authorities, what usually results in soon opening of bankruptcy proceedings, because company has lost its reputation and cannot conduct money laundering activities anymore. Close cooperation with several companies can also be a typical red flag of money laundering, especially if these companies are also suspicious. It is not unusual that they are fictitious companies. The period between founding of a company and starting illegal activities varies significantly, so it can be extremely short (smaller companies). On the other hand, there are also cases of established companies that have been on the market for many years, even decades (larger companies). A significant proportion of companies, after serving a perpetrator's purpose and committing a criminal offence, opens a bankruptcy proceeding and gets liquidated. Such sequence of events is logical (especially for small companies), since its founders have no further intention of adhering to the going concern accounting principle. Larger companies are not so susceptible to aforementioned difficulties. Companies from research sample corroborated findings of Bubić and Šušak (2015) that “there is a statistically significant relation between financial structure and opening bankruptcy proceeding as well as between capital structure and opening bankruptcy proceeding” and that “it is more likely that companies which have equity ratio lower than 50% will be more riskier and exposed to bankruptcy”, because companies which have opened bankruptcy proceeding and got liquidated had negative value (or very low value) of capital and reserves compared to total liabilities. An international component of money laundering activities is often present. Thus, it is often the case that the members of corporate bodies are foreign nationals and that other companies involved are also foreign. This highlights the need to coordinate the activities of domestic and foreign government bodies and financial institutions which have proved to be an important component of the money laundering detection system.

#### 4. CONCLUSION

The main aim of this research was to analyse which financial and non-financial information can be used to deduce distinctive characteristics of companies involved in money laundering. Findings indicate several red flags which can potentially implicate fraudulent and unlawful activities – significant increase of income, collaboration with fictitious companies which exist only to aid unlawful activities, using companies which are mostly small entrepreneurs and not subjected to rigorous regulations, internationality of operations usually exists etc. These red flags are more apparent and easier to detect when analysing financial statements of micro and small entrepreneurs, because medium and large entrepreneurs have large figures in their balance sheets and income statements, which is more suitable for camouflage. The process of auditing has not proved to be very effective in detecting accounting manipulations and unlawful activities related to money laundering. Presumptive reasons for aforementioned fact are absence of auditor's rotation and engaging audit firms which do not belong to Big Four. In conclusion, it is much more riskier to do business with micro and small companies which have manifested some of the red flags that can indicate money laundering because they are less likely to continue stable operations than medium-sized and large companies.

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## WRITTEN COMMUNICATION OF A LARGE ORGANIZATION WITH MATURE CONSUMERS

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### ABSTRACT

*The objective of the article is to identify and adapt key elements of written communication of a large company with mature consumers. The article contains an analysis of the consumers' expectations regarding the communication channel, the adaptation of individual elements of the writing, the visual side and the substantive content of the written communication. The article includes the results of qualitative research carried out by the authors in cooperation with a large energy company in Poland and the universal principles of constructing written communication. It was proposed to adapt the identified elements, which are important for mature consumers, to their preferences.*

**Keywords:** *energy, mature consumers, qualitative research, written communication*

### 1. INTRODUCTION

Efficient written communication, compliant with the highest standards in this area and the expectations of the addressees, is a very crucial element in building the relations of a large organization with consumers [Raciti, Dagger, 2010, pp. 103-111]. This is particularly true in the case of serial correspondence, sent to many recipients, and at the same time perceived by the customer as an individualized form of contact with the company. For this reason, corporate correspondence should be personalized, which is often difficult to implement in the case of a large scale of the company's operations. In this context, large organizations recognize the need for a deeper analysis of changes in customers' purchasing behavior, understanding their preferences and approach to how to receive / understand written correspondence, to adapt this form of communication to the expectations of their recipients. Companies analyze questions or problems, which clients most often address to them to develop templates that facilitate answering. From the point of view of effective communication, it is important to shape the message so that it is properly understood, to determine what permanent elements such correspondence should contain and how to plan the writing visually. For this reason, qualitative research was carried out in cooperation with a Polish large energy company (electricity seller, one of the five largest energy sellers in Poland). The energy company, which has about 2 million customers, sends thousands of letters every day, and every employee dealing in written correspondence responds to dozens of customer inquiries. This makes it necessary to use ready-made response templates that employees can further modify.

It is important that these templates are professionally prepared, easy to personalize and, above all, adapted to the changing expectations of customers. The structure and mechanisms of functioning of the energy market in Poland do not differ from the structures and mechanisms that have developed in most European countries recognized as competitive markets. Since 2007, Polish clients have had, on equal terms, wide access to various forms of electricity sales. Customers can change the energy seller, this change is free for the first time, while the next change costs depend on the provisions of the contract concluded with the seller. It should be emphasized that in the case of customer dissatisfaction with services or service level, they have the opportunity to change the provider. Final customers, who are on the demand side of the retail electricity market, constitute a group of over 17.05 million, of which 90.3% (15.4 million) are recipients from the tariff group G, including the overwhelming majority of household customers (over 14.5 million). The remaining group of final recipients are industrial, business and institutional customers belonging to tariff groups A, B and C [Energy Regulatory Office, [www 1](#)]. This article is the first paper in the series devoted to written communication. The purpose of the article is to identify and adapt key elements of written communication of a large company with mature consumers to their preferences. The study identified consumer segments to examine their preferences and find out what different expectations have different customer groups. The article will analyze the results of the research on mature consumers (over 40 years of age). In addition, young customers and companies were also tested (see: research methodology).

## **2. COMMUNICATION OF ORGANIZATIONS WITH CONSUMERS**

The concept of communication is derived from the Latin words: *communicare*, which means to make a common, connect, confer, communicate to someone, be in a relationship, participate, and *communis*, which means the pursuit of communication, community with another person [Latin-Polish dictionary] 1973, p.101]. Therefore, the purpose of communication is agreement between and mutual understanding of the parties. The evolution of perception of the concept of interpersonal communication can be found in the works of: Shannon, Weaver [1948], who developed a cybernetic signal transmission model, later adapted by other researchers to illustrate the process of interpersonal communication. Communication studies are an important area of research relating to the activities of the organization (e.g. Bavelas and Barret, 1951; Simon, 1976; Engel, Warshaw and Kinnear 1998; Kelly, 2000; O'Sullivan et al., 2005; Simon and Violani 2011). Depending on the type, objectives and resources of the company, conditions of competition, market structure, type of recipients and readiness to take risks, three communication models are presented in the literature [Blythe, 2002, pp. 13-15; Wiktor, 2013, p. 42; Kramer 2013, p. 11; Taranko, 2015. p. 36]: mass communication, interpersonal communication, communication in hypermedia IT environment. While the first two models are traditional, the communication model in hypermedia IT environment combines the possibilities offered by earlier models, and also introduces a new quality of the marketing communication process. The message can have a multimedia form, extremely varied (text, drawing, picture, motion, sound, animation). The content and form of the message change qualitatively, as the participants in the communication process can change their roles.

## **3. WRITTEN COMMUNICATION SPECIFICITY**

Written communications include: notes, letters, e-mail, faxes, internal bulletins, notices placed on notice boards or any other form of written communication involving words or symbols [Robbins, 2004, p. 225]. Communication through the written word requires the use of words, which constitute about 7- 10% of all messages transmitted. Its characteristic feature is that there is generally no possibility of direct contact and shaping the situation in which our information reaches the addressee [Stankiewicz, 1999, p. 111].

Written communication is primarily aimed at the permanent preservation of the information contained therein. [Trotsky, 2012, p. 321]. It can also be used for more complex matters requiring the involvement of more people (a group of experts). Symbols and choice of fonts that influence the perception of the company and may be an element enabling recognition of the brand are also important in marketing communication [Cvitić, Šimić, Horvat, 2014, pp. 49-50]. The company's written communication should be linked to the company's vision. Research shows that there is a correlation between the clarity of the company's vision and the quality of written communication of the company [Sethi, Adhikari, 2012, pp. 43-48]. Written communication is appropriate when it is necessary to provide accurate information. The disadvantages of this form of communication include: long waiting time for a response (compared to direct or telephone communication), especially when it is necessary to use external mail, the possibility of inaccurate understanding of the content by the addressee and a very official character, which is building distance between the parties. Written communication significantly affects the quality of the relationship between the sender and the recipient. It is worth to follow certain rules that facilitate communication. J. Pulitzer formulated the following principles of correct written communication: short - for the text to be read, clearly - for the content to be understood, figuratively - for the information to be remembered, - exactly - so as not to be misled and encourage action [Drucker, 1992, p. 153]. Raciti and Dagger's research has shown four components of written communication that influence the development of customer relations: message clarity, aesthetics, accuracy and physical features [Raciti, Dagger, 2010, pp. 103-108].

#### **4. CUSTOMER SEGMENTATION**

Persons communicating in writing must be able to organize and clearly express their thoughts, both in formal and non-formal correspondence. It is necessary to match the message, vocabulary and form to the circumstances, so as to use this form of expression for the best communication with its addressees [Simerson, Venn, 2010, p. 197]. In the serial correspondence, due to the difficulty of adapting the letter to an individual recipient, it is advisable to segment the buyers, enabling the most important elements of the letter or form to be adapted depending on a given group the recipient belongs to. Along with generational changes and rapid development of the technical and technological environment, it is possible to observe the formation of communication habits characteristic for the analyzed market segments (e.g. baby boom generation, generation X, generation Y, millennials). Each of the analyzed generations, being a segment of consumers, is characterized by attachment to different products, services and an approach to innovation. There is also the problem of education in the purchase and operation of new devices. The habit and trust in proven forms and communication channels becomes the basis for making decisions. Mature people who have been examined (over 40 years of age) are included in the X generation and the baby boom generation. Generation X (32-46 years old). Although "Xs" are familiar with technology, use computers and smartphones, they mostly rely on face-to-face contacts or a written form as well as paper archives. The baby boom generation (54-72 years, as a post-war baby boomer generation) is characterized by the stability of behaviors and trust in written correspondence.

#### **5. RESEARCH METHODOLOGY**

Contemporary qualitative research is different from the research which for the first time in 1946 was described by Robert Merton and Paul Lazarsfeld (Merton, 1946). The changes observed in classical qualitative research are a consequence of two phenomena: thanks to the findings in psychology of the last 20 years, which were popularized under the name of behavioral economics (Ariely, 2009) and the emergence of new technological solutions that allowed



relatively easy collection of data from respondents using the Internet, e.g. bulletin board or analyzes based on information present in the network (discussion groups or social forums).

In the face of such opportunities, traditional qualitative research must focus more on what cannot be explored using new methods and technologies - that is, they should focus on the study of unconscious processes accompanying attitudes and consumer behavior (Maison, 2015, Tyszka, 2000). Qualitative research provides two-way communication and detailed analysis of the issues discussed. Thanks to in-depth interviews, there is the possibility of careful observation of real feelings and finding the causes of specific conduct and decisions of participants. The presented research was conducted in Szczecin, in the focus workshop in the Service Inter Lab center from 13.06 to 06.07. The authors of this article were responsible for the scenario of the research, selection of respondents and moderation of interviews. The energy company provided sample templates of written communication and participated in adjusting the scenario of the research to the specifics of the industry. People using the services of the energy company, selected in a targeted manner were the respondents. Differentiating criteria included: gender, age, education, as well as the type of customer - individual or business.

In the first stage of the study, three focus group interviews (FGI) were conducted - two among individual consumers divided into young people (up to 40 years of age) and mature people (over 40 years) and one of the company's representatives. At this stage, five in-depth individual interviews with entrepreneurs (IDI) took place. During the second stage of the study, i.e. the verification stage, two research groups were accepted - individual persons and corporate customers. The aim of the verification study was the analysis of modified, exemplary templates prepared on the basis of the changes proposed by the participants in the first stage of the change study. Each group interview (FGI) was attended by 7-8 participants, this is the optimal number due to the duration of the study and possibility of an effective examination. The objectives of the focus studies and individual interviews were as follows:

- Objective 1: Analysis of customer behavior and preferences regarding written communication.
- Objective 2: Analysis of the current state of written communication in visual terms.
- Objective 3: Analysis of selected elements of the written message in terms of its affordability.

The written communication presented during the research included, for example, personalized letters based on templates provided by the energy company and which concerned the most common cases of correspondence with consumers.

## **6. DESCRIPTION OF THE FINDINGS**

### **6.1. General expectations from communication**

At the beginning of the study, participants were asked to present spontaneous associations with the electricity seller brand. Most of the respondents had positive impressions from the relationship with the company. Despite the fact that the respondents recall problem situations with the energy company, after all, the feelings and associations with the brand are positive. Problems were solved, doubts were quickly explained, and apologies from the company expressed, which was positively assessed by the participants. Correspondence with individual consumers has a lower frequency (compared to corporate customers) in total several times a year and is limited to sending invoices and information about changes in tariffs. Other writing that the respondents received from the company concerned, e.g. overdue payments, errors in settlements, consent for the connection or unjustified calculation of interest.

#### *6.1.1. The preferred form of contact*

During the contact with companies, older people prefer written correspondence, which is caused by the materiality of this form of communication. The letter sent, and the response received can be archived and photocopied for possible appeals. The written correspondence of both parties also allows to accurately describe the problem, as well as to provide detailed explanations or expectations. The respondents did not wait long for a response from the company - in the case of mail correspondence, the preferred waiting time for a response is a week, and a maximum of two weeks.

#### *6.1.2. Electronic form of correspondence*

Individuals who were considered mature in the study (over 40 years of age) can be divided into additional segments due to the use of Internet communication. Internet use is common among the youngest Poles 18-24 years (100% Internet users) and almost common among people aged 25-34 (96%). There is a greater diversity in the examined age group. Among respondents from 35 to 44, it is 87% of people, while among people from 45 to 54 years only 70% of people use the Internet. Over half of people aged 55-64 and three-quarters of the oldest Poles (65+) do not use the Internet at all (CBOS, 2017, p. 2). Older people, who use the Internet, find electronic form of communication with the company convenient. Due to the short, specific form of e-mails, this form of communication is even preferred by these people. An important advantage of e-mails is the possibility of archiving them. Some elderly people said that they do not use e-mails in formal correspondence with companies and prefer to send a traditional letter. The respondents also evaluated sample emails from an energy company. Their form, especially shortness and affordability, was very positively evaluated. In the test company, a separate department is responsible for electronic correspondence, people employed in it are trained so that the correspondence would not be too extensive. The presented e-mails included graphic forms, which were also evaluated in the study. Thanks to a well-formulated e-mail subject, credible sender's address, and the headline with the logo of an energy company in the content, participants believe that it is easier to identify the sender and feel safer. For the respondents, it is preferable that the graphics with advertising offers are active so that after clicking you can enter and read the details of the offer on the website.

#### *6.1.3. Using electronic help-desk*

The barriers to Internet use are noticeable in the group of mature clients. These respondents prefer to get a paper invoice. In this group, many people pay their bills in a very traditional way, i.e. in post offices. In this group of respondents, only a few people aged 40-60 pay their bills via electronic banking, but they are also reluctant to use an electronic service office. Even the login process on the site is a problem for older people - they are afraid of providing all their data. Some respondents use the invoice payment function in the form of SMSs and evaluate them very highly. People who have this form of "reminder" have assessed that it is useful for them. On the other hand, the other respondents are afraid that if they make their phone number available, then companies will send text messages that they do not want.

#### *6.1.4. Understanding the message*

Compared with corporate customers, individual clients are much worse at understanding the content of official letters, which include correspondence from the energy company. The samples of written communication presented during the study posed a considerable difficulty, especially for the elderly. The first observation of the study participants is that letters from energy companies are usually written in small print and contain numerous legal articles, which makes it difficult to understand them. In addition, many terms used in the writing are unclear for the participants and abbreviations are used (e.g. the DSO shortcut is used instead of the

"distribution system operator"). The respondents stated that all abbreviations should be explained (explanation of the abbreviation can be placed in brackets), because these abbreviations are not widely known and used. The elderly had to read the entire text several times to understand its meaning.

#### *6.1.5. The length and look of the written communication*

Presented samples were assessed as too extensive, because the content was often written on 3-4 pages. Participants of the study believed that they should be on 1 or on 2 pages at the most. If the writing is too complicated, the elderly need help to understand them and turn to their relatives or go personally to the customer service office so that a company employee explains their content to them. From the company's point of view, this is not beneficial because it extends the communication process, and the visit of the customer at the service point generates additional costs for the company. Letters sent to older people should be focused on providing the most important information so that the recipient can see what steps should be taken in order to deal with the matter. Letters should be carefully prepared from the visual side - the respondents pointed out that the company should standardize the size of the margins and ensure that the content is justified so that it looks more professional. The company paper design with a clear company logo (placed at the top of the letter on the left), which enables quick identification of the sender and finding all contact details was perceived positively.

#### *6.1.6. Font size and bold*

Older people notice deterioration in the quality of vision, which comes with age. For this reason, the respondents did not accept the fonts used in the company that were too small. Letters addressed to the elderly should be written in a larger font, e.g. Arial 11 or 12, so that they can be read without glasses also by far-sighted people. The respondents pointed out that some information in the content should be emphasized. For example, in a reminder, the payment amount and payment date should be written in bold, so that the customer can find them more easily.

#### *6.1.7. Construction of sentences*

The presented writings were perceived as incomprehensible. The very headline, whose role is to explain the content of the writing, was often formulated in a too specialized and extended way. Also, the content of the letter does not explain what the recipient is to do and what is the company's decision in his/her case. Sentences are too long and complex, while according to the participants of the study they should be shorter.

#### *6.1.8. Explanation of a complicated procedure*

The letters sent from the energy company in many cases relate to complicated procedures through which the customer has to go to get a solution to the problem. The examined elderly people said that such a procedure should be divided into next steps and be clearly marked in the written communication. For all letters, the next steps, requiring the client's actions, should be explained in detail, but shortly. As everything is described in the letter, then no additional documents or leaflets are needed.

### **6.2. Analysis of standard elements of written communication**

#### *6.2.1. Customer identification number*

The participants believed that the number should be placed and additionally underlined by bold letters, because it is used for identification during communication. In the template shown, this number was in the upper part of the writing on the left. The respondents believe that the number should also include the name and surname of a given client, so that it is clearly known that this number applies to him/her. Hence the suggestion of the respondents to transfer this number to the address field - and place it under the customer's address.

#### *6.2.2. The phrase "concerns"*

The respondents expressed the opinion that the headline as an introduction should be in the letter at the beginning of the letter before the welcome phrase (top left), but the explanation must be brief and understandable. The form "concerns" is accepted, and thanks to this element one can quickly find out what the company is writing about.

#### *6.2.3. Courtesy phrases*

In the formal correspondence of the company with consumers, the recipient should not be addressed by name, but courtesy phrases are to be used. The form "Dear Sir (s)" is admissible with the surname, but there are mature respondents who prefer the phrase Dear Sir / Madam, Ladies and Gentlemen. At the end of the letter, the respondents suggest a formal phrase "sincerely".

#### *6.2.4. Legal basis*

Energy companies, but also many other organizations, are legally obliged to inform their customers about the legal grounds on which they base their decisions. For this reason, the templates presented contained references to legal provisions that were included in the content of the letter as the numbers of legal acts and specific paragraphs, and in some cases these provisions were further cited. The examined elderly people think that they usually skip this content, and it might be useful only when the matter goes to court. Legal provisions often discourage them from reading the writing and make them feel that they will not understand this message anyway. The respondents suggest that the legal provisions should be at the end of the letter, and only the links should be included in the content. With such a form, the addressees focus on the content of the writing, and those who are interested can check which regulations are the basis for the issue.

#### *6.2.5. Courtesy phrases in the content of the letters*

The correspondence presented to the participants had often at the beginning of the writing a phrase "Thank you for contacting company X". Most respondents believe that this phrase is unnecessary. Sometimes it is illogical - it should be adequate to the content of the letter. E.g. considering the complaint, it is more appropriate to use a phrase "in response to a complaint". Other phrases were perceived as kind and, according to the respondents, should appear in such correspondence regardless of the issue of the writing. However, moderation is also indicated in this respect, and too polite expressions, for example, warmly, with bows, with expressions of respect are not positively perceived. If the company commits an error or causes inconvenience to the client, the older respondents expect letters of apology from the company.

#### *6.2.6. Signature*

The signature "Yours sincerely Customer Service" has been assessed negatively. According to the respondents, the person who writes the letter should sign it with the name and surname and provide his / her position, so that it would be clear who to contact in a given case and who is formally responsible for the content of the written communication.

#### *6.2.7. Contact information*

In serial correspondence, data for contact with the company are usually found in the footer or headline of the letter. In the analyzed letters, they were in the footer of the writing in the form of graphic elements and contained information about the eBOK, website, hotline and e-mail. The respondents analyzed whether this form is enough, or they expect it to be repeated. Participants suggested that it would be a good idea to have information about the person who can be contacted in a given case, and not only general information for the customer service

department. Mature consumers in the presented footer lacked an address to which they can send a letter by traditional mail. Older people perceive the helpline badly, because during a conversation one has to wait for a connection with a consultant, and additionally calls to special numbers are more expensive than standard ones. According to mature respondents, it is better to come to the service office and discuss the matter personally.

#### 6.2.8. Advertising of company's products

The correspondence examined was designed so that the advertisement of other company's products was included on the back of the letter. However, this solution was negatively evaluated by respondents. The advertisement was noticed, but according to the respondents it is not needed, it is better that the letter has fewer pages, and the promotional information can be attached to the writing in the form of a separate leaflet.

### 7. CONSLUSIONS

Mature people who took part in the study believe that letters sent to them should be short, specific, written in simple language, preferably informing about one issue only. Expectation has been expressed that the content should not exceed one A4 page. From the point of view of the elderly, a larger font, explaining the "step by step" procedures, avoiding technical terms, abbreviations and citing extended legal provisions are key elements. In the study, the participants had to form a letter from the puzzles, which suited them best in terms of the layout of fixed elements, which made it possible to match the templates of the letters to their preferences. Common elements of the layout (from the top of the page):

- letterhead - containing the logo,
- unified date format (place, day.month.year)
- complete customer data together with the number,
- an explanation of what the letter concerns,
- welcome phrase,
- the content of the written communication (unified margins, justified text),
- farewell phrase (on the right side of the traditional letter),
- legal aspect at the end in the form of links,
- attachments
- contacts as a footer in a letter (letterhead: all contact details for the company including mailing address).

This arrangement results from the traditional layout of the formal letter, but it is worth noting that it is modified by information contained on letterhead (e.g. address of the sender). The respondents also paid attention to the aesthetics of the writing, so that they had positive visual aspect and were the hallmark of the company (color logo, justified text, standardized margins). Written communication is a specific type of company communication with clients, which for many clients is the basic form of contact with the energy supplier. In other cases, this is important and, above all, the most tangible certificate of service quality and complementation for other communication channels. Therefore, companies should particularly care that this form of communication is professional and builds positive relationship with consumers.

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## AN ANALYSIS OF WORKING CAPITAL MANAGEMENT IN CENTRAL UNITS OF GROUP PURCHASING ORGANIZATIONS

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### **ABSTRACT**

*Working together, creating various types of multi-entity organizations is the current standard. This activity is generally preferred by small and medium-sized enterprises and those who see that in a given period and in a given market competition is strong and that functioning without additional support may end up in the bankruptcy of the company. The most common way of such cooperation is functioning within purchasing organizations. They are a type of organizations where there are no capital ties. They are created in all industries and are managed through a separate company, a central unit. This unit is often called a purchasing group or a central group of the purchasing group. It is the 'brain' of the entire organization, and in principle it depends on its effectiveness whether the purchasing group will achieve the intended results. In order the central unit could run effectively the entire purchasing group, it must have a stable financial base and, above all, have a positive working capital. The purpose of the article is to analyze the management of working capital in central purchasing groups.*

**Keywords:** *working capital, central unit, purchasing group organization*

### **1. INTRODUCTION**

Company management is a constant battle for a contractor. In order a company could compete effectively with competitors, it must have a secure financial base, i.e. an ability to settle current liabilities on time. This ability is guaranteed by working capital. Managing it is a very complicated process since it is based on current assets and current liabilities. Thus, the decisions made in this area are short-term ones. The company's management staff cannot afford errors in this area, because if you choose a bad policy, there may be downtimes in production and sales, which will adversely affect the entity's financial results. Suspending sales, in turn, may lead to payment bottlenecks, which is the first step towards a loss of liquidity and then bankruptcy. According to many authors, weaknesses in business management are the cause of corporate bankruptcies, including: lack of competence and skills in the field of business management, personal characteristics, e.g. excessive optimism, insufficient motivations (Oooghe, De Prijcker, 2008, pp.223-248). Baldwin confirms that the weakness of management was the main reason for bankruptcies of enterprises in Canada (Baldwin, 1998, p.200). Other authors also believe that the way of business management has a big impact on the risk of losing financial liquidity (Ma et al., 2014, pp.1-8). Personnel management, therefore, has a major impact on the company's financial security, that is, on the level of working capital. The process of working capital management in companies managing multi-stakeholder organizations, such as purchasing groups, is even more complicated. These companies have a huge impact on the financial security of enterprises operating in the purchasing group. They directly affect the management of the most important elements shaping the level of net working capital, i.e. inventories, receivables, current liabilities and cash. In a sense, they are responsible for their financial security. To guarantee them to individual participants of the purchasing group, they must first of all take care of their financial security. When the management company of the purchasing group has problems, it will immediately be reflected in the financial situation of individual units operating in the purchasing group.

## 2. WORKING CAPITAL

Net working capital is defined as current assets decreased by current liabilities (Bringham, Houston, 2005, p.120). Therefore, it is the capital financing a certain part of current assets, the one which is not covered by current liabilities, and thus constitutes the surplus of current assets over current liabilities (Dębski, 2004, p. 214). It is the arithmetic difference between current assets and current liabilities (Sagner, 2014, p.1). Managers can use the following working capital management strategies: (Zimon, 2017a, pp.531-538)

- Conservative strategy is a safe strategy. Its aim is to secure financial liquidity in a company. It consists in keeping the assets at a high level and short-term liabilities at a relatively low level. In the structure of current assets the advantage of inventories over receivables is noticeable. Companies implementing this way of management keep a high cash position. Conservative management of working capital is due to the conservative policy of inventory management, account receivables and safety management policy commitments that are timely adjusted.
- Aggressive strategy is a risky method of working capital management. It aims to keep current assets at a low level. Current liabilities are at a very high level. Very often this way of management means bankruptcy for a company in a long period of time. To rescue the company managers will try all the time to keep a faint edge of current assets over current liabilities. In this way the company will have the capacity to pay current liabilities. This strategy minimizes the most liquid assets or cash, it also seeks to minimize inventories and receivables are maintained at a high level. This is due to aggressive management of receivables, inventories and liabilities. The high level of receivables is a result of the sales of goods, products to each customer even unreliable ones. It is a risky strategy.
- Moderate strategy aims to minimize the weaknesses of the previous strategies and maximize their advantages (Szczyński, 2007 ,p.213).

Most often enterprises use indirect strategies. The choice of an aggressive strategy is a high risk of action. Such a management method must be supported by a high technological level so that sales or production downtime do not occur. A conservative strategy is an expense. The costs of providing excessive safety. Such a strategy may result in waste in the warehouse and subsequent additional costs resulting from loss-making.

## 3. CENTRAL UNITS OF GROUP PURCHASING ORGANIZATIONS

The group purchasing organization is a group of cooperating companies that jointly control and streamline the flow of goods, information and money from suppliers to final recipients. Participants in such a system form a separate central unit, whose main task is to meet the goals set by the companies operating in the system (Zimon, 2017b, pp.675-682 ). In their research, the authors, as the most important benefits offered by functioning in purchasing groups, mention a reduction in the prices of purchased goods (Tella, Virolainen 2005, pp.161-168), reduction of administrative costs (Nollet, Beaulieu 2005, pp.11-17,) costs (Burns, Lee 2008, pp. 203-215). Benefits also arise in the case of managing receivables from customers, liabilities to suppliers, which positively affects financial liquidity (Zimon, 2018, pp.87-104). Purchasing groups consist of the main management unit and other enterprises. In general, the central unit of the purchasing group is a specially created company whose main task is to manage the entire organization. The main tasks it is to carry out are:

- Negotiating the terms of purchases with counterparties, the Central Unit negotiating with the producer obtains an attractive price and the buyer's credit, and very often an additional discount for an earlier payment. (Zimon, 2018, pp.87-104)
- Organization of purchases of goods, materials and services,
- Organizing trainings for group participants,



- Occasionally supporting companies with low financial liquidity by extending them trade credit,
- Control of compliance with the rules in force in the group,
- Acquiring new enterprises

The central units of purchasing groups should be divided into two categories:

- Units created by participants in a given group. Individual companies form such a company and have their shares in it. Such a central unit is easier to control. The central purchasing group operating in this way will not be focused on the maximum yields.
- External units. The management company of the purchasing group is a "foreign" entity that is completely unrelated to the participants of a given group. Enterprises operating in such an organization have no control over such a company. This company has to earn on itself and is interested in how each independent unit earns high profits.

Companies managing a purchasing group can also be divided into two types:

- Traditional,
- Internet, that is, those that operate on the principle of internet portals looking mainly on the Internet for micro and small units, e.g. pharmacies or individuals, who are often interested in one-time purchase. After purchase, the company withdraws. There are few permanent participants in this type of organization.

Another important division of the central unit is the division into:

- Modern, these are such units that have a warehouse. It can be described as a central warehouse.
- Standard, without central warehouse.

Having a warehouse means a number of benefits and some drawbacks. The most serious disadvantage is the additional costs of its maintenance. Participants in the purchasing group incur higher costs of maintaining the centrality unit. However, an efficiently functioning central unit with a warehouse gives the opportunity to order a larger quantity of assortment. That often allows to get additional benefits in the form of an even lower price or longer period for repayment of obligations. Central unit for the assortment stored in the warehouse imposes additional margins, selling it gains the most. Despite the fact that such a commodity is more expensive compared to the product purchased on the basis of standard procedures for group purchase of companies that need it at the moment, they have the immediate possibility to supplement the range further at an attractive price of additional margins calculated by the central unit. In group purchasing organizations one can observe a strong influence of the central unit on most elements creating working capital in enterprises operating in the group. The details are presented in figure 2 (Zimon, 2017a, pp.531-537).

*Figure following on the next page*

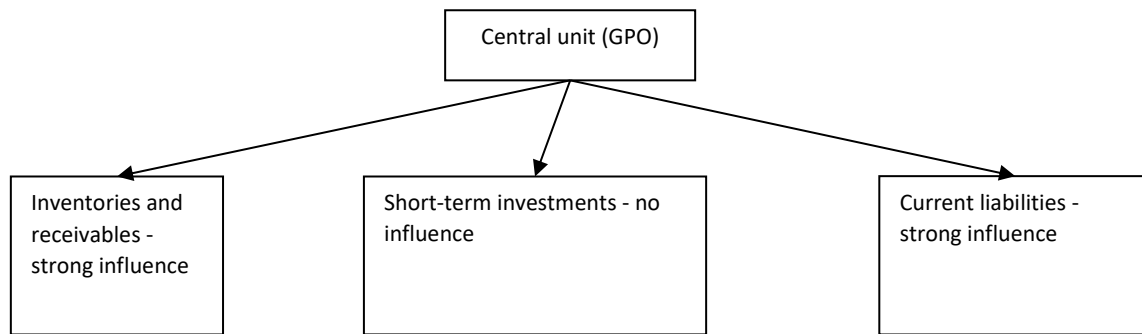


Figure 2: The influence of central unit on elements creating working capital

Source: author's own research

Joint purchases allow to get an attractive price and a long period for liabilities payment. A long-term payment gives an opportunity to acquire new customers by offering favorable trade credits to its customers, which increases the level of debt. The level of commitments depends on whether there are possibilities to pay obligations sooner or if companies use the credit period till the end (Zimon, 2017a, pp.531-537). Inventories are usually kept above demand. It results from the desire to obtain the lowest prices by increasing the scale effect. Companies with a central warehouse give the purchasing group participants an opportunity to reduce the level of orders. It is possible thanks to the possibility of supplementing the shortages from the central warehouse, further with an attractive price, despite the fact that it is increased by the central unit. The impact of purchasing groups on the level of cash is little. Companies through mutual transactions may improve the level of working capital, but the condition of such transactions is the high level of liquidity of one transaction participant.

#### 4. AN ANALYSIS OF MANAGEMENT OF WORKING CAPITAL

The analysis included two central units of purchasing groups operating in the same industry. The first of them is a company formed by participants of a given purchasing group (enterprise I). The second is an external company not related to the participants of the purchasing group (enterprise II). The period of research is 2014-2016.

Table 1 presents selected items regarding the structure of assets in the analyzed enterprises.

Table 1: Asset structures in the analyzed enterprises

	2016	2015	2014
Share of current assets in total assets - enterprise I (%)	99	99	98
Share of short-term receivables in current assets - enterprise I (%)	89	86	82
(%)Share of inventories in current assets - enterprise I (%)	10	13	17
Share of cash in current assets - enterprise I (%)	1	1	1
Share of current assets in total assets - enterprise II (%)	99	99	99
Share of short-term receivables in current assets - enterprise II (%)	76	81	79
Share of inventories in current assets - enterprise II (%)	23	13	7
Share of cash in current assets - enterprise II (%)	1	6	12

Source: author's own research

The presented analysis has shown that there is practically no fixed assets in the examined units. From the point of view of current financial liquidity, this is positive information. In any enterprise, however, there should be fixed assets, they are to some extent information about solid foundations of the enterprise.

The analyzed companies deal with the provision of services related to negotiating purchase terms for participants of purchasing groups, which is why fixed assets are practically unnecessary for them. In the analyzed enterprises, receivables from customers prevail in the structure of current assets. Inventory is at a minimum level, they are sold almost immediately. In central units, which have a warehouse, stocks can be more. They are stored for further sale on more favorable terms to the participants of the purchasing group. Next, using the basic measures of financial liquidity, the level of financial liquidity was assessed. Table 2 presents detailed results of individual financial liquidity ratios.

*Table 2: Financial liquidity ratios*

Liquidity ratios	2016	2015	2014
Current ratio I	1,2	1,16	1,2
Quick ratio I	1	1	1
Current ratio II	1,1	1,1	1,1
Quick ratio II	0,8	1	1

*Source: author's own research*

The presented ratios of current financial liquidity are at a low level. This level should be assessed as risky for maintaining the company's financial security. The fast liquidity indicators get much better results. They are at a very good level, current assets with a high degree of liquidity cover current liabilities. Table 3 presents the turnover rates of the most important elements affecting the level of turnover capital.

*Table 3: Turnover ratios of the most important elements affecting the level of working capital*

Turnover rates in days	2016	2015	2014
Debt turnover in days I	56	61	42
Stock turnover on days I	6	10	9
Liabilities turnover on days I	52	61	42
Debt turnover in days II	50	56	61
Stock turnover in days II	15	9	8
Liabilities turnover on days II	61	63	68

*Source: author's own research*

When analyzing the turnover of individual items of current assets and current liabilities, the focus should be on liabilities towards suppliers and receivables from customers. In the case of enterprise II, receivables have a faster impact compared to the maturity of liabilities, which is very positive for the working capital management process.

*Table 4: Relationship between receivables from customers and liabilities to suppliers*

Ratio	2016	2015	2014
Ratio of receivables from customers to liabilities towards suppliers I	1,36	1,23	1,44
Ratio of receivables from customers to liabilities towards suppliers I	1,22	1,3	1,23

*Source: author's own research*

In both cases, one can see the advantage of decency over obligations. Enterprises are, therefore, a lender. They try to support participants of purchase groups. The visible advantage of the receivables over liabilities informs about the positive working capital in enterprises.

Table 5 shows the results of the cash conversion rate. This ratio informs about the average number of days in which an enterprise finances current assets from capital other than liabilities. (Dębski, 2004, p.233)

*Table 5: Cash conversion cycle in the analyzed enterprises*

Conversion cycle in days	2016	2015	2014
Cash conversion cycle I	12	10	9
Cash conversion cycle I	4	2	1

*Source: author's own research*

The results in table 5 mean that this period is very short. From the moment of payment for the purchased goods to the moment of receipt of funds for the sold goods, for an average company, about 10 days on average, and for the second unit about 2 days.

Table 6 presents results informing about the period for which working capital is sufficient.

*Table 6: Net working capital in days*

Working capital in days	2016	2015	2014
Working capital I	11	10	10
Working capital II	6	6	7

*Source: author's own research*

In principle, in the case of enterprise 1, these results coincide, in the case of the second company, the working capital level is higher than the demand by an average of about 3 days in each of the examined periods.

## 5. CONSLUSION

Companies operating in a group are in a sense a buffer that protects an individual unit from losing financial liquidity. Especially, the central unit, which is created by participants of a given purchasing group. Enterprises operating within the purchasing group, in principle, are able to assist it at any time when there are problems with settling their current liabilities. But this is not their role and task. An efficiently operating central unit should secure cash for repayment of current liabilities and additionally support enterprises that have a low level of working capital, i.e. low liquidity. On the example of both companies functioning as central units, a few similarities and characteristics for the management of working capital in the central units are clearly visible. In both cases, there is a positive working capital, its level is practically in line with the demand for it. Both companies have a low current liquidity ratio and high fast liquidity liquidity. Both enterprises are a lender, in both enterprises a high level of receivables in current assets is visible. The payment turnover is faster than the turnover of liabilities, or often the same. In the case of the efficiency of managing receivables, a higher level of their outflow is noticeable in the unit created by participants of the purchasing group. The effect on this result is efficient management and extensive knowledge of participants of such a group, but also the influence of the central warehouse is also visible. Enterprises order goods in quantities as they are needed at any given time without surplus. They are able to pay for the ordered goods at any time if they are missing from the central unit's storage for which they are able to pay. All this allows to shorten the waiting period for the flow of receivables. To sum up, central units apply aggressive and moderate strategies. The net working capital is at a low level, which practically barely covers the demand. Positive feedback should be given to the level of the fast liquidity ratio which presents the central units as entities that can cover all liabilities very quickly. Its result is in a sense a guarantee of safe operation of central units. The strategy applied should be assessed positively because if it moved towards a conservative, high-cost one, individual

participants of the purchasing groups would assess the central unit as a company operating inefficiently in the market.

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## **SOCIETAS UNIUS PERSONAE – POSSIBILITY FOR ENHANCING CROSS BORDER BUSINESS OF SMALL AND MEDIUM SIZED ENTERPRISES?**

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### **ABSTRACT**

*The purpose of this paper is to analyse the regulatory framework of different supranational forms in European Company Law, and how it can benefit small and medium-sized enterprises. Furthermore, what are the potential benefits of introducing the new form - Societas Unius Personae? Special focus will be put on similar forms of companies in national company laws, the number of registered companies in the national court register, and problems that arise in everyday national and cross-border operations. In April 2014, the European Commission, as part of its package on corporate governance and company law, published a proposal for a directive on single-member private companies with limited liability, the so-called Societas Unius Personae (SUP). As part of the Europe 2020 growth strategy, its main objective was to make it easier and less costly to set up of companies across the EU, as well as to facilitate cross-border trade. According to the proposal, the SUPs would have only one share and one shareholder. The Member States would be required to provide for its online registration, giving the possibility to SUP founders to incorporate and register an SUP from their computer, without a need to travel to the country of registration. In addition, the minimum capital requirement to set up an SUP would be 1 EUR. The Directive was especially intended to benefit small and middle-size enterprises active outside their country of incorporation. Such objectives are commendable; however, some stakeholders expressed concerns regarding the actual implementation of such a proposal. In October 2017, the proposed Directive has been withdrawn, and so the author will propose possible practical solutions and further steps.*

**Keywords:** *Cross-border operations, European Company Law, Directive on single-member private companies with limited liability, Societas Unius Personae*

*“In our thriving EU Single Market, companies have the freedom to move and grow. But this needs to happen in a fair way.”*

*Commission Vice President Frans Timmermans*

### **1. INTRODUCTION, OR WHAT HAPPENED WITH SOCIETAS UNIUS PERSONAE?**

On the European Union Single Market, there are around 24 million companies, out of which approximately 80% are limited liability companies. According to the Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law, around 98-99% of limited liability companies are SMEs. As stated in the Proposal, the companies increasingly use digital tools in their business and they also need to interact with public authorities, but this is not always possible through online means. In the EU there are significant differences between Member States when it comes to the availability of online tools for companies in their contacts with the public. Achieving a deeper and fairer internal market is one of the 10 key priorities of the Commission, together with the development of the Digital Single Market. The Digital Single Market Strategy stressed the role of public administrations in helping businesses to easily start business, operate online, and do business across borders. Also, the e-Government Action Plan specifically recognised the importance of improving the use of digital tools when complying with company law related requirements. The proposal for a Regulation on the Single Digital Gateway emphasises the importance of digital tools and processes to help businesses to take

full advantage of the Single Market and requires the full digitalisation of the most important administrative procedures for cross-border users. In its 2017 resolution on the e-Government Action Plan, the European Parliament called on the Commission to consider further ways to promote digital solutions for formalities throughout a company's activities and underlined the importance of work on the interconnection of business registers in order to facilitate cross-border operations of small and medium enterprises (SMEs). In 2014, the Commission's Proposal for a Directive on single-member private limited liability companies – frequently asked questions, or so-called *Societas Unius Personae* /SUP/ ([http://europa.eu/rapid/press-release\\_MEMO-14-274\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-274_en.htm)), stated: the “European small and medium-sized enterprises (SMEs) are the backbone of the EU economy: the 20.7 million SMEs produce 58% of EU GDP and account for 67% of all jobs in the private sector”. With full advantage of the opportunities of the single market in particular its 500 million consumers using their products and services. Furthermore, the Proposal underlined that “many SMEs face obstacles trying to do so”. They find it in particular costly and difficult to be active outside their own country and as a result, only around 2% of SMEs take up activities abroad (in the form of a subsidiary, branch or joint venture).” Comparing 2014 and 2017, we had 4 million companies more and no solutions. According to the MEMO, the difficulties regarding the SUPs arise due to legal, administrative or language obstacles, as well as due to the lack of trust in foreign companies amongst customers and business partners. Meeting legal and administrative requirements in other countries leads to costs related to legal advice and translation. These costs are likely to be even higher for groups companies which want to establish in a number of Member States and need to follow different regulatory requirements in relation to each subsidiary. Bearing in mind that small and medium-sized enterprises are required to carry out cross-border activities and in view of the judgments of the European Court of Justice in the area of the freedom of establishment, the Member States have embarked on a reform of their national regulations governing limited liability companies. (Jurić et.al., 2015). The aim of the proposal for establishing the SUP was not to introduce a new legal form at an European level, like *Societas Europea*, European Economic Interest Grouping or *Societas Cooperativa Europea*, established as supranational company forms (Horak et al., 2010; Boschma, Schutte-Veenstra, 2017). Often referred to as “the 29<sup>th</sup> regime” due to the fact that there were 28 different national company laws /after BREXIT in 2019, 27 Member States/ as a result of the implementation of EU Directives in national company laws of EU member states (Horak et al. 2010, Boschma, Schutte-Veenstra, 2017), the intention of the proposal was to make it possible for the Member States to make available in their national legal orders a national company law form for single-member private limited liability companies (Horak, Dumančić, Šafranko, 2013) with a number of harmonised main requirements and one common name, *Societas Unius Personae* (SUP) or, as some authors call it, the possibility of an EU company law passport (Conac, 2015). The proposal left the choice of how to introduce such a company law form at national level to the Member States. For instance, the legal form of an SUP might be an additional company law form, co-existing with other national forms for single-member private limited liability companies in a particular Member State. In such case, the founders of companies would be able to choose the most suitable one for their business. Alternatively, if a particular Member State so decided, the SUP legal form could become the only national company law form available for such companies in that country. As the SUP would be a national and not a European legal form, it would not require a self-standing independent regulatory framework. Therefore, the issues which are always the focus of interest, like employees participation, transfer of seat, taxation, would be regulated by national law. According to one of the explanations, it was necessary to offer a national company law form for single-member private limited liability companies at EU level. This still meant convergence and not harmonization.

A number of analyses showed numerous obstacles at EU level. This explains why it is not always possible to achieve harmonization purely through the implementation of the Directives by the Member States. At EU level, an instrument that allows for the establishment of single member private limited liability companies already exists, i.e. the Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies, *OJ L 258*. This Directive provides for limited harmonisation of the relevant national laws by specifying that companies may have a single-shareholder in all Member States and by regulating the powers of that single member in relation to a company. As to the criticisms against the Directive, it has been noted that the Directive does not address many key issues such as formation, registration requirements, creditors' protection or minimum capital requirements. Also, as stated before, it does not help reduce the costs of establishing companies across borders (Jurić et.al.,2015). The idea was that the SUP proposal would replace the existing Directive. In practice, Member States had already accepted the idea that the Commission could intervene in this area since they had already accepted a degree of harmonisation.

## 2. LEGAL SOURCES AND NEW SOLUTIONS

As many authors agree, freedom of establishment is the indisputable cornerstone of the European Union Company Law and Internal Market enshrined in Articles 49 and 54 of the Treaty on the Functioning of the European Union (TFEU). Also, after a long and quite successful journey of the European Court of Justice judgements *Centros* C-212/97 [1999] ECLI:EU:C:1999:126; *Überseering* C-208/00 [2002] ECLI:EU:C:2002:632; *InspireArt* C-167/01 [2003] ECLI:EU:C:2003:512; *Sevic Systems* C-411/03 [2005] ECLI:EU:C:2005:762; *Cartesio* C-210/06 [2008] ECLI:EU:C:2008:723 in favorem of Internal market and with *VALE* C-378/10 [2012] ECLI:EU:C:2012:440 and recently *Polbud* C-106/16 [2017] ECLI:EU:C:2017:351, a wide path for cross border mobility has been opened. In the first generation of judgements, the European Court of Justice held that, if a company has been validly established under the national law of a member state, then another member state, in which the company carries out its economic activity or has its actual seat, cannot affect the legal personality of that company by applying its own legal regulations (Jurić et al. 2015). In the *Polbud* case, the main question that the ECJ had to answer was whether there was a restriction of freedom of establishment where the removal of the company concerned from the commercial register of the Member State of origin, as a condition for the completion of a cross-border conversion, was subject to that company's prior liquidation and winding-up. According to the AG Kokott Opinion and in line with the information supplied by the referring court, the transfer of a Polish company's seat within the European Union does not lead to the loss of legal personality under Polish Law. Even if the law applicable to the company is changed, the company's identity would be maintained. The ECJ judgment is consistent with the AG Opinion, and it states that the Polish legislation constitutes a restriction on freedom of establishment. Such a restriction may, in principle, be justified by overriding reasons in the public interest, such as the protection of the interests of creditors, minority shareholders and employees. However, the Polish legislation prescribes, in general, mandatory liquidation, there being no consideration of the actual risk of detriment to those interests and no possibility of choosing less restrictive measures capable of protecting those interests. Such a requirement goes beyond what is necessary to achieve the objective of protecting the interests of creditors, minority shareholders and employees. Finally, as regards the argument of the Polish government that that legislation is justified by the objective of preventing abusive practices, the ECJ held that, since a general obligation to implement a liquidation procedure amounts to establishing a general presumption of the existence of abuse, such legislation was disproportionate. In business practice, the exercise of the freedom of establishment by companies remains difficult.



One of the reasons for these difficulties is that company law is not sufficiently adapted to cross-border mobility in the EU: „It does not offer companies optimal conditions in terms of a clear, predictable and suitable legal framework which could lead to enhanced economic activity, in particular for SMEs as recognised by the 2015 Single Market Strategy“. Regarding the legislative competences in drafting the SUP proposal, it was clear that, contrary to the / Commission's proposal/, the provisions on the SUP cannot be based on the competence to attain freedom of establishment (Article 50 TFEU). Two criticisms have been directed against this legal basis. First, the SUP proposal would violate the principle of subsidiarity. Second, the proposal should have been based on Article 352 of the TFEU as Article 50 of the TFEU does not allow for the creation of new national company forms (Conac ,2015; Petrović et al.,2015;Malberti, 2015; Boschma, Schutte-Veenstra, 2017). Although the EU can harmonise the national company law rules that the companies must adhere to for the protection of shareholders and third parties, in particular creditors (Art. 50 (2) (g) TFEU), this Directive went much further than that. For example, some rules relating to the right to online registration did not provide such protection. The EU can effect the progressive abolition of restrictions on the freedom of establishment in relation to setting up subsidiaries, agencies or branches (Art. 50 (2) (f) TFEU). This is conditional upon these measures having a cross-border element because the basic right to freedom of establishment (Art. 49 TFEU) only applies in such cases. (CEP) A cross-border element exists where a (natural or legal) person sets up a permanent establishment in another Member State, which has not been the case with the SUP due to the fact that, as previously stated, the citizens can establish SUPs in their own country. Hence, it cannot be applied to those cases which do not have a cross-border element. The scope of the SUP is significantly wider than the competence under Art. 50 TFEU. It is doubtful if the Directive can be based on the competence to approximate laws in the internal market (Art. 114 TFEU) as it actually doesn't facilitate an approximation of legal systems. Consequently, it has been challenged in the scientific literature, with various authors presenting the pros and cons (Petrović et al. 2015; Conac, 2015; Boschma, Schutte-Veenstra, 2017) about whether it can therefore be based only on the flexibility clause (Art. 352 TFEU) as is already the case with the existing supranational company form, which the SUP obviously wasn't (CEP). When pointing out other issues with the SUP, the Latin name and the abbreviation “SUP” have also been disputed. Typically, when the Latin language was used in naming e.g. European Company/Societas Europea or European cooperative/Societas Cooperativa Europea, it was used so as to ensure unanimous recognition and usage in any EU Member State, as a „brand“ for supranational/EU formation of companies. So, when used for the SUP, it was misleading because it didn't have supranational “brand”. Among other issues with the SUP, there was much criticism against the provision that newly established SUPs must be able to register online so that the shareholder would not have to appear before an authority or notary. The Commission's intention was to adopt, by way of implementing acts, uniform templates that the shareholder must use for registration and the articles of association. The Member States were encouraged, without obligations, to accept the templates in other official EU languages, which is quite difficult to achieve because the official language of the Court register is usually the language of the Member State (CEP). It was proposed that the verification of information as to their completeness as well as compliance with the national law and of the identity of the shareholder should be carried out in accordance with national law. However, the fact that the Directive does not contain any obligation to carry out the verification was seen as problematic. When verifying the identity, the country of registration must recognise the identity documents issued by another Member State, including those issued electronically. The national legislative reforms were aimed at simplifying the process of establishing and registering limited-liability companies. This particularly refers to the introduction of electronic registrations, which reduce the costs and the time needed to set up a company.

However, this type of registration is not equally available to the domestic and to the foreign legal entities in the member states. As regards the registration validity check, it is often performed twice, first by public notaries, and then by court registers as well (Jurić et.al., 2015; Petrović et al.2015). Hence, it can be concluded that a complete design of the electronic registration legal framework is needed, with the goal of preserving the existing level of safety, and that the Member States should be allowed to perform an electronic authentication of biometric indicators inseparable from the person whose identity is under verification. Verification and authentication via video link, performed by notaries, should also be considered. Such direct communication and feedback, among other things, would allow notaries (Position of the Council of the Notariats of the European Union concerning the proposal for a Directive on the single-member private limited liability company (SUP)) to exercise their role in the prevention of money laundering and terrorist financing (Petrović, 2015), which was one of the issues regarding the SUP Proposal pointed out by stakeholders. Many stakeholders, in addition to the Member States, expressed serious concerns regarding the SUP Proposal. Among them, the ETUC in its Open letter to the Members of the Legal Affairs Committee on 27. April 2016, ETUC SUP-the European Panama, has been warning against the SUP Proposal ever since its publication. They strongly argued that the Commission's proposal generated concerns with regard to fiscal evasion, workers' rights and sustainable corporate governance in general. They also expressed their strong concerns that it could led to same situation like the Panama Papers scandal: "The establishment of thousands of letterbox entities in Panama was made possible in particular by letting companies register a head office in a different location to that where their economic activity took place and profit was generated. Such a "split seat" approach is expressly permissible in the proposed SUP, enabling large and small companies alike to pick and choose the EU jurisdiction where control requirements, tax and labour law liabilities are comparatively low - regardless of where they are economically active. This incentive to establish artificial corporate structures is further reinforced by the 1 euro minimum capital requirement and fast online registration (without formal identity checks!) - making it quick and easy to establish letterbox structures throughout the EU." So, as a result, the proposal for the SUP has finally been withdrawn in 2017, because the control measures weren't strong enough for the EU and its Member States to afford the type of deregulatory approach proposed by the SUP. The new EU Company Law Package has been issued in April 2018 with some, at least at first glance, almost satisfying solutions, which will surely be analysed in detail in the next months. Practice has shown that, from the standpoint of employee protection, minority shareholders and creditors, the real seat approach should be strengthened and, for the sake of other EU goals and the freedom of establishment, it should be "harmonized" and balanced with these goals, especially from the socioeconomic point of view and to avoid the erasure of the European Social Model (Vitols, 2018). By introducing new procedural rules contained in the Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions COM/2018/241 final - 2018/0114 (COD) /second proposal within EU Company Law package 2018 for cross-border conversions and divisions, companies would be provided significant clarity and significantly reduce the costs for companies wishing to convert or divide cross-border. As stated in the Preamble, it would provide clarity to national business registers to clearly distinguish the point in time to which a company can enter the business register in the destination Member State and be struck off the business register in the departure Member State which would avoid situations such as Polbud.

### 3. CONCLUSION

Company Law has always primarily been part of national law, especially in terms of creditors' protection, shareholder rights, and employee participation.

Looking back on the past, the implementation of EU Company Law directives into the national laws of Member States resulted in a degree of convergence, but it has also created obstacles due to different implementations and various solutions for achieving the aims and goals of the Directives. Through the years, the attempts to find a solution on EU level in favorem of freedom of establishment and the internal market have shown that half solutions and compromises simply don't work in business practice. Or, more accurately, some solutions cannot find their way to actual implementation due to the (future) 27 different company law systems. It is encouraging for all stakeholders and the future of Social Europe to see that the SUP Proposal has been withdrawn, and that the present European Company law package with two proposals takes an approach in favorem of shareholder, employees and creditors, creating the much needed legal security and, hopefully, the prospect for a support of digitalization in company law solutions as well as a less costly and less complex environment facilitating cross-border operations for SMEs on EU level.

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## COURT SETTLEMENT – THE HISTORICAL CHALLENGE OF THE CIVIL PROCEDURE OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

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### ABSTRACT

*The historical turning point of the classical civil procedure in Bosnia and Herzegovina in the big and extensive reforms of the civil procedural law was brought by the regulations about court settlements regulated by the Civil procedure act of Bosnia and Herzegovina in 2003. This document follows the trend of international and European standards of human rights' protection in regard to the rights of a fair trial. The Institute of court settlement as enforceable document allows the parties to terminate the dispute and to avoid all possible anomalies of the classical civil procedure.*

**Keywords:** *historical development of court settlement, the settlement agreement, enforceable document*

### 1. INTRODUCTION

One of the strategic programmes in the justice sector reform strategy in Bosnia and Herzegovina from 2014 to 2018 is enhancing the application for alternative dispute resolutions. The main indicator is to be seen through the amendments of juridicial laws, improvement of the institute of court settlement and judges trained for a wider application of the institute of court settlement. The changes of juricial procedures for the purpose of satisfying the needs and interest of a modern legal system are highly necessary. The legal system in its classical, traditional form has reached the point to turn towards the Anglo-Saxon law's impact through the prism of peaceful dispute resolutions and a stronger parties' impact on the completion of the dispute (ŠIMAC, 2017, p. 173 – 205). A developed legal system differentiates two major legal systems – the Eurocontinental and the Anglo-Saxon, i.e. Anglo-American legal system. The big legal system whose composition is made by the legal system of national states of continental Europe, Latin America, and some states from Asia and Africa is usually defined by different names: European continental legal system, Roman law, Greco-Roman law, Romano-Germanic law, The legal system of Civil law (KOŠUTIĆ, 2008, p. 11.). The main characteristic of this legal system is the separation of powers and the juridicial independence in matters of procedural guarantee of freedom and human and civil rights. The whole state is submitted to the law, especially with the system of juridicial review of acts of both administrative and legislative branches of the government (the primacy of the Constitution over the laws and other sources of justice). There is also a juridicial monopoly in deciding about unlawful acts and their sanctions to their offenders (KOŠUTIĆ, 2008, p. 29 – 30). The Anglo-American legal system is primarily found in England and the United States of America (PRAVNI LEKSIKON, 2007, p. 35). The main characteristic of this legal system comes from the fact that the biggest number of legal rules was created by courts. The rules and principles were caused by the court and the main source of law is the precedent (PRAVNI LEKSIKON, 2007, p. 35). The Anglo-American legal system is not based on the Roman law, whose concept of law includes a public and a private law, but in this legal system there is no reception or codification of legal system as there is in the

European continental legal system. The Anglo-American law is based on the common law and equity law, and lately on the statute law. Courts enforce the law as a precedent not following the law acts, but the verdicts that explain and enforce that act (PRAVNI LEKSIKON, 2007, p. 35). One of the main differences between the European continental and Anglo-American legal system is the difference in basic legal concepts and institutions and their different classification (PRAVNI LEKSIKON, 2007, p. 35). The legal system in Bosnia and Herzegovina is facing big challenges in the 21<sup>st</sup> century. The legal system, legal institutions, jurists, all have to answer and support the modernization and globalization process (ŠIMAC, 2016, p. 171). The influence of Anglo-Saxon law on the classical, continental civil procedure can be seen through the prism of parties' influence on the legal system as the safest mechanism of dispositive authorisation to conclude a dispute on the court through Institutes of court settlement. There is a wide resource of tools on the way to the transformation of a traditional system of dispute resolutions. The gentlest, but also the safest way of that influence is a court settlement as a potential carrier of positive changes in the whole legal system.

## **2. THE HISTORICAL REVIEW OF THE CONCEPTION OF ALTERNATIVE DISPUTE RESOLUTION**

The history of peaceful dispute resolutions has existed so long as the existence of dispute, i.e., the need to have those disputes resolved. Historically, the alternative dispute resolution in the modern sense is not the first attempt to affirm the need and possibility of a peaceful dispute resolution. There are reports about a certain kind of mediation – a peaceful dispute resolution even in the earliest days of human society. Historians assume that there have been cases of mediation in commercial disputes among old Phoenicians but also Babylonians. That practice developed in old Greece, which, in disputes, which were not marital, or family disputes, knew the institute of a mediator called proxenatas. Old Romans knew certain procedures similar to mediation, and in the Roman law, there is an annotation about a peaceful dispute resolution in Justinian's Digest from 530-533. The Romans had different names for a mediator - internuncius, medium, intercessor, philanthropus, interpolator, conciliator, interlocutor, interpres, and at last, a mediator. With the fast development of science and technology, the development of economic relations, communication and democracy, social relations have become so wide that the state with its legal system was not able to regulate them (BEŠIĆ, p. 255). In this situation, states are obliged to find other methods of dispute resolution. Sometimes the person who mediated the dispute resolution was considered a holy person, a person who deserved special respect. Usually those were individuals who with their character and/or social status gained a priori the trust of other members of the society, and people in dispute. Different aspects of dispute resolutions were used through history and in the resolution of international disputes, especially in the political sphere. E.g. arbitration in conflict resolution between Greek polises, the mediation of Catholic popes in conflict resolution between Europe's countries during Renaissance and in international efforts to preserve mundial peace at the end of the 18<sup>th</sup> and the beginning of the 19<sup>th</sup> century. Beside the political sphere, alternative dispute resolution were used in labour and trade disputes during the 20<sup>th</sup> century, but they succumb an intensive development during the 70s in the United States of America. The introduction of new laws, which protect individual rights, promote tolerance and prohibit discrimination, has provoked an affluence of lawsuits in courts. The Legal system became weighted which resulted in delays, but also in procedural mistakes. During the late 70s, the alternative dispute resolution was put into service in Europe. First, it was in Great Britain, and then, in Nordic countries. The alternative dispute resolution starts to be used outside the economical sector. There was one especially significant moment for the European development of alternative dispute resolution in community disputes and criminal procedures and that was an article, Conflict as Property, by a Norwegian Criminology professor, Nils Christies.

That book reflects the essence of the idea of introducing new models in dispute resolutions (CHRISTIE, 2016). This paper affirms the need for the parties in dispute, as well as local communities encourage and strengthen so much that they take the initiative to solve the dispute. He highlights the need to engage a neutral person from the community to mediate the conflict between parties which would finally result in the conflict resolution carried by their real owners. It can be said that this article was the basis for creating a legal frame for alternative dispute resolution. Nowadays in Western countries, an alternative dispute resolution is intensely used in almost all spheres of social life, because social conflict arise in all spheres of life. Alternative acts solve trade, work, family disputes. These acts help to reconcile the victim (damaged) and the culprit making them active participants in the process. Alternative forms of dispute resolution have become present in schools, among children, where peer mediators mediate in cases of different disputes and violence during school class. In the history of the Balkans, the dispute resolution was present in the tradition of old Slavs who realized that bloody fights weaken the society and certain tribes volunteered to become mediators suggesting the victims of a crime to give up on the revenge and instead take a compensation in money or goods. In medieval times, it was mentioned that there was a third person in the Balkans who mediated or made the decision in disputes (ŽIVANOVIĆ-BUŽANIN, 2009, p. 32). In 1883, the principles of Austrian civil litigation in the form of the Code of Civil Procedure of Bosnia and Herzegovina of 1883 (hereinafter GPP from 1883) applied in the territory of Bosnia and Herzegovina, which also envisaged a court settlement. (ENGELSFELD, 2006, p. 100 – 101). Paragraphs from 256 to 25 in GPP from 1883 organized the Institute for court settlement, which came in the record and were signed by both parties. The next procedural law on the territory of Bosnia and Herzegovina was the Law on Court procedure in civil procedures of the Kingdom of Serbs, Croats and Slovenes from 1929 (hereinafter GPP from 1929) which predicted the possibility of completion of procedures with a settlement that was in the records (OMANOVIĆ, 2003, p. 100 – 104). The further historical development of procedural laws which predicted court settlement were the Law on Civil procedure of Federal People's Republic of Yugoslavia I 1957 and the Law on Civil procedure of Social Federal Republic of Yugoslavia from 1977. Court settlement could be concluded in the phase of the preparation of the main discussion, as well as during the discussion (DIKA, 1991, p. 683 – 704). With the Bosnia and Herzegovina's independence there was a reformed Law on civil procedure of the Federation of Bosnia and Herzegovina from 1998 which predicted the possibility of a free disposal of demands set during the procedure (DIKA – ČIZMIĆ, 2000, p. 25). A new reform from 2003 (hereinafter ZPP from 2003) predicted the possibility of dispensational termination of legal proceeding under court. However it is important to make a distinction between these aspects of dispute resolution and modern models, which beside the fact that they are incorporated in the legal system, also have clear frameworks and work principles. People who follow them have to satisfy high standards and run a professional training and knowledge tests. These contemporal procedures of alternative dispute resolutions are seen in the period after the war on the territory of former Yugoslavia and in the process of social transition and mostly under the influence of trends in countries which are more experienced in their usage, but are adjustable to the local context, tradition and needs.

### **3. THE EXISTENCE OF CONFLICT**

At the beginning of this paper, it is important to make an explanation of the term conflict, which is an international term for confrontation and what brings a relationship to that dispute. A conflict is a relationship between two or more parties (individuals or groups) who have irreconcilable views. The word conflict comes from the Latin word *confligere* which means to fight, kick, while in Chinese it means danger. Although the word “conflict” provokes mostly negative associations, it is neither bad nor good- neither negative nor positive. It is a sign that

the existing relationships are ready to change. Negative associations come from bad personal experiences regarding conflict. The development and the outcome of a conflict can be constructive or destructive, depending what the involved and the third parties do about it. However, not all conflict participants are equally ready and have the same knowledge and skills to constructively deal with the conflict resolution. When a certain conflict occurs, it is approached with certain assumptions. Some of them can be helpful for the resolution, but others are dazzling and complicate the process of understanding the other party and finding a creative possibility of solving the dispute peacefully. In this case there are steps which could help that conflict end effectively and with permanent results. There is a theory about causes and ways to solve conflicts. One group of theories says that the main cause is bad communication or the absence of communication at all. They approach to conflict by establishing communication and tolerance. Others think that the cause is the irreconcilable position and different views of the conflict and they believe that in the process of conflict resolution it is important to separate the personality from the problem and to seek a mutually acceptable frame of conflict and within it find adequate agreement (ŽIVANOVIĆ–BUŽANIN, 2009, p. 17). There are theories which indicate that the causes of a conflict are the endangered identities of the parties in it and that through dialogue with the other party it is important to find out why there is fear, what is endangering them and to move towards reconciliation. To determine easily the ways to approach the conflict resolution, it is important to see the differences in their complexity. Some are pretty simple, momentary, can be resolved fast and easily. Others are multilayered and the conflict we see is only the trigger but not the real cause of all the reactions. It is very important for this paper to establish the level of conflict called dispute which is a conflict based on rights, usually solved in formal procedures, by regulations, convictions and other acts based on the law. The conflict resolution demands certain preparations which vary depending on the cause, level and conflicts' complexity but also the interests of conflicting parties.

#### **4. COURT SETTLEMENT**

With the change of society and law there was a moment when the legal institutions opened and enhanced the parties' impact on the completion of procedures with a material dispositive process of completing court settlement. The court settlement is a transitional mechanism from traditional classical litigation to the development of alternative ways of ending a dispute (ARAS KRAMAR, 2016, p. 193 – 211). The court settlement is a contract concluded and registered in front of a court in which the parties try to settle their disputable relations. It is equal to the final judicial decision (ČIZMIĆ, 2004, p. 211). Court settlement as a dispositive civil procedure of both parties is considered from the aspect of material and procedural law (ČALIJA-OMANOVIĆ, 2000, p. 244). Court settlement has certain procedural and legal effects but it is also an agreement through which parties regulate their civil relationships. A court settlement brings to the completion of procedures and according to its legal nature, can be condemnatory, constitutive or declaratory (TRIVA-BELAJEC-DIKA, 1986., p. 473). Parties can negotiate a settlement about the dispute during the entire procedure up until its legal conclusion (court settlement) (art. 87. par. 1. ZPP from 2003). If the court settlement was brought after first instance verdicts, the Court of First Instance will bring the solution which will establish that the first instance verdict is inoperative (art. 87. par. 2. ZPP from 2003). The court settlement represents a contract concluded in front of a court, with which parties can resolve the dispute completely or partially. The court settlement can refer to the whole claim or only one part of it (art. 87. par. 1. ZPP from 2003). A settlement cannot be concluded in court regarding demands of whose parties do not dispose. (art. 89. par. 2. ZPP from 2003). When a court reaches a verdict that does not allow the settlement of parties, the procedure is paused until the resolution becomes valid (art. 89. par. 3. ZPP from 2003).



A concluded court settlement has the equal effect as a valid court verdict (art. 91 ZPP from 2003). It is a mixed, procedural and civil law (TRIVA, 1959, p.209)

#### **4.1. The characteristics of court settlement**

A court settlement is a dispositive civil procedure of both parties. In the aspect of legal nature of court settlement, in legal theory, the most acceptable view is the one about its dichotomous nature. Court settlement represents a civil law contract through which parties arrange their material legal relationship, but at the same time the civil procedure of parties with which they influence the outcome of the procedure, with the legal validity as the final consequence (KULENOVIĆ, 2005.). The security derived by the process of reaching a court settlement lies on the fact that the whole procedure happens in front of a court, which guarantees legal validity, but also finds a solution that meets the needs of opposed parties. In order to have the strength of a distraint proceeding a court settlement needs to have legal validity. It becomes legally valid in the moment of closure. The parties' will is the most important thing in the whole process, i.e., their will to resolve the dispute by settling. The main motive is to end the juridical proceeding without further dispute. Voluntarily, the parties themselves decide whether they will accept the court's initiative or suggest the conclusion of the settlement themselves dealing with the dispute the best way they can. The court guarantees legal validity and the implementation of the deal as in the case of juridical decision. The practice is that in every proceeding the court has to initiate the process of court settlement during the first encounter with the parties – it on the preliminary hearing as well as during the whole procedure trying to get the parties to settle without compromising its impartiality. Concluding the agreement both the parties and the court are spared the lengthy trial of a court proceeding, which inter alia implies: adjournment of additional hearings, unnecessary obtaining and conducting evidence, making a court decision, appeal against a decision, lengthy settlement proceedings, possible second instance proceedings, and avoiding the numerous extra costs of regular court proceedings. The court settlement also allows the maintenance of business cooperation or private relations between the parties in the proceedings. On the other hand, a court verdict implies only one possible solution to a dispute based on a law, which is not always good for the parties. By nature, court settlement can be condemnatory, constitutive and declaratory.

#### **4.2. The characteristics of negotiating a court settlement**

These presumptions must be met for the admissibility of a court settlement: judicial jurisdiction, proper composition of the court, contractor's ability, legal interest in concluding contracts as a court settlement, permissibility of cases and contents, and prescribed forms of court settlement contract (TRIVA, 2004, p. 570). The court settlement leads to the finalization of litigation, i.e. to prevent further litigation. After court settlement, the parties lose legal interest in seeking legal protection (ČIZMIĆ, 2004, p. 209). In that case a prosecutor's statement to withdraw the lawsuit and defendant's to agree upon, becomes redundant and unsustainable. Apart from litigants, court proceedings may also be brought by third parties, in which case the court settlement does not immediately lead to the ending of the lawsuit. The subject of court settlement can only be the relations that parties can freely dispose of, i.e. those that may be the subject to litigation. The court settlement must be concluded in writing before a court of competent jurisdiction and may be concluded during the second-instance proceedings, pending the adoption of a final verdict. If a settlement is reached, the agreement goes into the record. Also, the court records the court's decision to refuse to conclude a settlement, so that in the case of second-instance proceedings, the court will assess the propriety of that decision. The court settlement is a peaceful, confidential, economical, voluntary and fast process. The parties' settlement agreement goes into the record (Article 90, paragraph 1 of the ZPP of 2003). The settlement is concluded when the parties sign the record (Article 90, paragraph 2 of the ZPP of 2003).

The agreement also contains a cost agreement. If the parties fail to reach an agreement on costs, it may be agreed that a decision on costs is to be made by the court (Article 90, paragraph 3 of the ZPP of 2003). The court will issue a certified copy of the record to the parties to the settlement (Article 90, paragraph 4 of the ZPP of 2003). For the validity of the court settlement, it is not necessary for each party to give up on its disputes. The court settlement will still be valid even if the defendant fully acknowledges the claim as well as if the defendant dismisses the claim in the settlement (ČIZMIĆ, 2004, p. 209).

#### **4.3. The abolition of court settlement**

In court practice, it is believed that a court settlement, although having the same effect, is not a court decision and therefore can not be challenged by appeals and other remedies, but merely by a lawsuit. Likewise, since the presence of parties is a presumption in a court settlement, a request for reinstatement cannot be requested either. The way of contesting the court settlement is determined by law. A court settlement can only be refuted by a lawsuit (Article 92, para. 1 of the ZPP of 2003). A court settlement may be refuted if it is concluded in error or under the influence of coercion or fraud (Article 92, paragraph 2 of the ZPP of 2003). The lawsuit referred to in paragraph 1 of this Article may be filed within three months from the day of the finding of the grounds for the offense and no later than five years from the date of the court settlement (Article 92, paragraph 3 of the ZPP of 2003). If the court settlement is repealed, the proceeding continues as though the court settlement had not been concluded (Article 92, paragraph 4 of the ZPP in 2003). It is not possible to complain against the verdict approved by the court which allowed the conclusion of a court settlement. If a court settlement has been concluded contrary to the legal order, but concluded in the area of legal relations in which the disposition of parties is in principle permitted, it does not lose the legal significance of the court settlement, and such a settlement, if one wishes to overlook its legal significance, can be refuted (Article 93 of the ZPP of 2003). The court settlement cannot be refuted by a proposal to repeat the proceedings. The court settlement may be refuted only because of the lack of will of the person who concluded it. In case of nonperformance, one cannot require the termination of contractual obligations, but only the execution.

#### **4.4. The active role of a judge in concluding a court settlement**

Judicial activity is crucial in the process of concluding a court settlement. It is his duty to seek the parties to conclude a court settlement, not jeopardizing his impartiality throughout the proceedings. He should point out to the parties the legal nature of the dispute, and taking into account the facts that are being brought in the proceedings and their position in the dispute. The principle of impartiality is what a judge cannot endanger in the whole process. The position of the judge in the proceedings is determined by law. The Court will endeavor to conclude a court settlement at the preparatory hearing and throughout the proceedings not jeopardizing its impartiality (Article 88, paragraph 1 of the ZPP of 2003). In order to reach an agreement, the court may, when it considers it to be grounded, propose to the parties to settle, taking into account the parties' wishes, the nature of the dispute, the relations between the parties and other circumstances (Article 88, paragraph 1 of the ZPP of 2003). If the parties approach the proceedings, the judge may ask the parties for the purpose of resolving any misunderstandings that may arise during the proceedings. If considered necessary, the court is obliged to ask questions to the parties to clarify the extent to which they have agreed and what is the content of their agreement and to warn them in what parts their agreement is unclear (ČIZMIĆ, 2009, 237). The problems that may arise from a court's attempt to conclude a court settlement are complaints of impartiality of a judge. If a plaintiff thinks that the judge has a strong influence on the lawsuit when the court makes a motion to conclude a court settlement, it can be perceived as a negative standpoint of the court relative to his possible success, or it can be considered that

the court prejudices the future decision (BEŠIĆ, p. 260). If it is suspected that a judge may be impartial when the court settlement is concluded, then each of the parties may use the institute of exemption from judges. The impartiality of judges is a fundamental precondition for an objective trial and proper decision-making. The Institute of Exemption is precisely the guarantee that a judge who is objectively questionable will not be tried in a specific case (HAUBRICH, 2016, p. 283-29). In the case that no settlement is reached on all disputes, the judge will refer the parties to further proceedings and the costs they incur. The court is ex officio obliged to see whether the litigation leads to a case on which the court settlement was previously concluded and if it finds that the litigation leads to the case on which the court settlement has been concluded, the lawsuit will be dismissed as inadmissible.

#### **4.5. Out-of-court settlement**

The parties can resolve the dispute by settlement outside the court. Such an agreement is concluded without the participation of the court, and thus does not constitute a litigation action and no legal effect of the court settlement. In the case that this settlement is concluded during litigation, the lawsuit does not go away by force of law, but continues, and the party's complaints will be considered by the court in the out-of-court settlement. The parties may indicate in the settlement that the prosecutor will withdraw the lawsuit after the conclusion. If he or she has not withdrawn the lawsuit the other party may file it as evidence. Unlike a court settlement that is aligned with a final court ruling on the same dispute, the out-of-court settlement is not a negative procedural presumption to initiate a litigation (ZEČEVIĆ, 531-532). Therefore the out-of-court settlement is concluded without court involvement. Such a settlement is not a litigation action and has no influence on litigation and also does not have the legal effect of the court settlement. So, if during a litigation a the court settlement is reached, the litigation continues and it does not go away by force of law (RADOMAM, 1981, pp. 1-9). The abolition of the out-of-court settlement is possible as well as court settlement – by a lawsuit.

### **5. STRATEGIC DOCUMENTS OF BOSNIA AND HERZEGOVINA IN THE SECTION OF ALTERNATIVE DISPUTE RESOLUTIONS**

Ministries of Justice of Bosnia and Herzegovina, entities and cantons, High Judicial and Prosecutorial Council of BiH (HJPC), Judicial Commission of Brčko District (JC BD) and representatives of professional associations of judges, prosecutors, attorneys, notaries, mediators and other nongovernmental organizations have developed the Justice Sector Reform Strategy for the period 2008-2012 which was accepted by Bosnia and Herzegovina's Council of Ministers in June 2006. A part of the Strategy – Support to Economic Growth is related to alternative methods in dispute resolutions and the strategic program states that it will ensure strategic guidelines for development of Alternative Dispute Resolution, Promote benefits of ADR at the level of executive authorities in BiH, continue promoting ADR among the business, legal and academic community, define clear mechanisms and activities of promoting and encouraging the use of mediation among the judges in BiH, strengthen the role of the BiH MoJ in defining policies for ADR and in the establishment of a system to evaluate and monitor the implementation and effectiveness of mediation, improve the capacity of the Association of Mediators in BiH in the development of: human resources; system of standardisation; training; licensing; and service provision, conduct induction training and provide ongoing professional development on successful referral of cases to mediation, as part of the professional development of judges, expert associates, apprentices and others, ensure a system of provision of mediation services throughout BiH, conduct a study on modalities of the wider application of mediation and other types of alternative dispute resolution in BiH, develop an action plan for enhancing the work of commercial departments of courts (STRATEGIJA, SARAJEVO, 2006.).

Expected outcomes of the strategic programmes include reduction of pressure on courts, improved quality of mediation services in BiH, increased awareness of key institutions of the benefits of mediation and ADR. In November 2013 the Ministry of Justice of Bosnia and Herzegovina completed a project of writing the Justice Sector Reform Strategy for the period from 2014 to 2018 which was completed in 2013. One of the programmes of this strategy was promoting alternative ways of dispute resolution but with expected results: the institute of court settlement, mediation and arbitration was improved by the law amendments, they developed a training programme for application of court settlement and arbitration and trained judges for wider application of the institute of court settlement, a system of extrajudicial mediation was improved and expended to several types of disputes through the strengthening of institutional capacities and human resources, as well as the system of ADR promotion among citizens through organizing mediation weeks, they developed analysis and proposal of amendments to the laws in order to prevent stalling of the process and to improve efficiency through ADR, and also developed capacities for application of mediation in cases of juvenile delinquency (STRATEGIJA, SARAJEVO, 2013.).

## 6. CONCLUSION

The increase in the number of cases, which needs to be addressed faster, updates the interest in the possibility of applying other dispute resolution methods. As can be seen throughout the topic, this paper highlights the importance of alternative dispute resolution between the parties. The effects of these methods realized in practice indicate that they are just significant holders of positive changes in the overall legal system, institutions and society at all. The judiciary of Bosnia and Herzegovina is burdened with a large number of cases, which are not resolved within the deadline. Such a procedure violates the fundamental rights of the parties, which is the right to a fair trial within a reasonable time. In addition to the violation of rights, citizens lose confidence in court proceedings, and thus in their own state, which should provide them protection in accomplishing the rights and interests. Therefore, the dispute resolution system is trying to improve by introducing alternative methods. These methods are replaced by a regular court proceeding, which is still the most common way of resolving disputed relationships in our judicial system. Citizens and businesses should no longer cause disputes and leave them in any state-run state courts. They should also be active participants in solving them and finding a common compromise solution that will meet the needs and respond to both sides of the dispute. This idea would have an evolutionary potential in terms of improving and promoting dispute resolution. No modern society no longer works without these methods. This way of dispute approach leads to the right in every sense being closer to the citizens and the needs of society. Alternative dispute resolution methods are considered to be a more effective and much more efficient way of solving court proceedings, especially in providing justice to citizens in countries where the judiciary has lost trust and respect for citizens who cannot or do not want to use court proceedings. Alternative methods in a broader sense serve as an excellent opportunity to make the world a better place to live. Alternative ways of resolving disputes are now recognized as a welcome tool for mitigating inter-party tensions, accelerating the process, and reducing litigation costs. In this way, parties solve their conflicts for a short period of time and it is important to keep the secrecy of the proceedings and what happened in it, which is very important to the interest of the parties. The development of alternative dispute resolution should be one of the most important interests of the judiciary of Bosnia and Herzegovina, due to the influence of these models on the judiciary, primarily in terms of system relocation, and due to the contribution of a fair trial within a reasonable time. These methods are one way of solving the dispute of a peaceful and civilized society trying to resolve the conflict through dialogue and in good faith, not using long-lasting and expensive practices that never see the end.

It is important that the BiH society develops a sense of a peaceful way of solving the existing dispute, and the judicial reforms in that regard positively influence and promote such a method of resolving the dispute. Therefore, the legislator's institution focuses on the dissolution of municipal courts by regulating the procedural rules on peaceful dispute settlement. Hence, a great faith lies in a solemn resolution of disputes, especially in the court settlement where the role of the court remains as a guardian of trust in the judicial system.

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## ONLINE DISPUTE RESOLUTION IN RUSSIA AND EUROPE - CURRENT SITUATION AND PROSPECTS OF DEVELOPMENT

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### ABSTRACT

*Online dispute resolution is a relatively new area, but it is quickly developing throughout European countries and Russia in particular. Settlements, especially out-of-court settlements are an efficient and cheap way to resolve disputes, but it requires using other alternative dispute resolution methods. For example, mediation proved effective as a stand-alone procedure and as an additional measure to help with peace settlements in courts. Arbitration is another useful alternative dispute resolution forum. Going online makes these methods even more efficient and easier to use and in some cases even leads to resolving disputes without participation of lawyers. The article is an in-depth research of this field, aiming to provide understanding of different forms of online dispute resolution, online mediation and electronic arbitration in particular and legal framework behind these forms of dispute resolution. Uses, strengths and weaknesses of online dispute resolution are being discussed. Some countries already provide necessary legal background for wide array of possibilities in online dispute resolution, while other countries could benefit from changes to legislation. The established European regulations and national legislation are being compared with Russian law; the author researches possible avenues for further advancing online dispute resolution specifically in Russia, and factors that may assist or hinder development of online dispute resolution in Russia considering recent arbitration reform. Online dispute resolution lessens the burden on courts in any country and greatly helps the public as a whole. Part of the article is dedicated to the problem of consumer rights dispute. High cost of court procedure compared to alternative dispute resolution makes it unviable to continue with established Russian trend of keeping consumer disputes in courts. Possible solutions to this problem are being discussed with focus on finding implementable solutions within current legislation framework. This development is necessary to ensure economic growth and investment attractiveness of Russia.*

**Keywords:** Arbitration, Consumer Rights, Online Dispute Resolution, Russian Law

### 1. INTRODUCTION

Out-of-court settlements is an effective and quick way to resolve most disputes. The settlement is a best resolution because it is a compromise between two parties positions, it saves both time and money and frees up courts to deal with other disputes. In other words, settlements are beneficial to general population, entrepreneurs and state itself, so most states try and create enticements for litigants to choose alternative dispute resolutions methods that lead to peaceful settlements. Court settlements are preferable to judgements as well but have fewer benefits: some court work is involved in reaching a settlement in court. Russia understands the importance of alternative dispute resolution (ADR) methods, so it tries to pass legislation in support of them. The most notable acts are Federal Law of July 27, 2010 No 193-FZ “On the alternative dispute resolution procedure involving intermediaries (mediation procedure)”, Federal Law of December 12, 2015 No 382-FZ “On Arbitration” and Law of the Russian Federation of July 7, 1993 No 5338-1 “On International Commercial Arbitration”. Acts on arbitration were amended recently during major reformation of arbitration system in the Russian Federation. Russian Duma also relatively recently passed new legislation regarding online instruments in state courts. Online instruments help diminish load on courts as well and as a side benefit protect natural resources.

Unfortunately, there are not so many innovations in a field of alternative dispute resolution and mostly new amendments don't really help to develop them.

## 2. ON ONLINE ADR

Bringing alternative dispute resolutions methods online is an obvious next step in development of ADR. As everything is now online or even blockchain so are ADR. But are the benefits real and is there any detriments to this happening? Thomson Reuters has published the report on The Impact of ODR (Online Dispute Resolution) Technology on Dispute Resolution in the United Kingdom in 2016. In that report it is stated that ODR technology deeply affected different groups: businesses, lawyers, regulators and courts. While the report is limited in a sense to the UK it should be noted (and is indeed mentioned in the report itself) that because of a cross-border nature of the ODR it is impossible to completely exclude effects on other countries, so we can safely presume that similar effects are observed throughout the Europe or possibly the world. ODR introduces new possibilities compared to ADR in general. The most obvious advantages are the speed of a procedure, reduced costs and improved accessibility, but that is not all, ODR offers some unique advantages as well. For example, ODR allows parties to have “silent auctions” on possible conditions to a settlement without any third party at all. One of the first ODR services was CyberSettle, which operated based on this principle. The system enabled participation in a out-of-court blind-bidding process: parties specified the maximum amount in the event of signing a settlement. A party would be able to send at most three proposals, until the other party proposed an equal or lower amount, the amounts were not disclosed to the other party. When the parties reached consensus, the offer would be mutually presented.<sup>1</sup> As some ODR may run fully automatically without need of human interaction and with modern encryption methods it is possible to achieve the ultimate level of confidentiality never before achieved in human history — not only no mediator knows of a dispute and discussed conditions of a settlement, but in some situations parties to the mediation itself don't know fully what was discussed which may prove extremely useful if they will fail to come to an agreement and will have to use more traditional ways to resolve conflicts such as courts. The more obvious ODR do not offer any unique advantages but just bring more comfort to already established methods — using something like Skype to connect to different parts of a country, for example, or even different parts of the world. Online mediation and online arbitration are possibly the most popular methods of ODR. Russia has almost no specific regulation of ODR. Rules governing ODR are mostly limited to the rules on communication between parties, what kinds of messages could be considered legally binding and so on. The Civil Code of the Russian Federation establishes that an agreement in a written form may be concluded by exchanging documents through electronic means that allow authentication of parties to an agreement. It should be noted that authentication requirement concerns the means of communication, not documents itself — it allows a wide scope of possible ways of authentication. Otherwise the only way to authenticate a document would be through using so-called electronic digital signature — an encrypted container that could only be decrypted using keys received from the other party which would be a proof of authenticity. Case-law distinguishes this as well and as such there is no exhaustive list of methods of authentication in the Russian Federation — a condition necessary to allow development of digital and internet technologies under the legal framework. Electronic digital signature is considered an analogue to a hand-written signature and as there is no requirement of signing documents exchanged between parties, there is no requirement to have it electronically signed as well. Unfortunately, in other situations the law still requires electronic digital signature as the only proof of authenticity, specifically when dealings with state courts — sending most documents to a state court requires electronic signing of these documents.

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<sup>1</sup> Mania, K. “Online Dispute Resolution: The Future of Justice.” *International Comparative Jurisprudence*, 2015. — p.77-78



While discussing ODR it is necessary to mention online arbitration. Throughout the world online arbitration is very different and developed in different forms. In Russia there is no specific regulation concerning online arbitration but no prohibition of online arbitration as well. One of the pioneers in the field of online arbitration in Russia is Russian Arbitration Association<sup>2</sup> — this institution does not act as a permanent arbitration institution at the moment because it did not get required authorization from the Government of the Russian Federation. It should be noted that getting an authorization is not an easy procedure and only two arbitration institutions in Russia got that authorization since arbitration reform. All the other institutions exist as ad hoc arbitration. There are some limitations to online arbitrations in Russia though that stem from general rules on arbitration. First of all, it is only possible for arbitration tribunal to issue an award without a hearing (based on written opinions submitted by parties and evidence) as long as both parties agree. If at least one of the parties insists then a hearing shall be held. Fortunately, hearing can be held using video or other means without needing for parties to travel to any one place. Secondly, an arbitral award has to include motifs to reaching a decision. Parties have no right to exclude motifs as necessary element of an arbitral award. This rule is sometimes being criticized as there is no way to challenge an arbitral award based on motifs, so parties shall be free to get an award without motifs if they want to — it would save time and in no way would infringe upon their rights or protection of their rights.

### **3. ON ADR AND ODR IN CONSUMER RIGHTS DISPUTES**

In Russia consumer protection is very strict, but that strictness limits consumers in a modern world and does not really benefit them anymore. There is some uncertainty as to availability of ADR to consumers in Russia, especially about arbitration. First of all, the law “On Consumer Rights Protection”<sup>3</sup> establishes that consumer rights protection is provided by courts. Some commentators believe it means that the only adjudication venue available for consumers is a state court, any dispute between a consumer and a seller or a provider of services may only be resolved by a state court. On the other hand, this rule is open to other interpretations. In Russian “court” and “tribunal” are defined by the same word and its meaning is dependent on the context. The law “On Consumer Rights Protection” has no definition of a word “court”. The law was passed at the time when there was no Constitution in Russia yet, it must be considered when interpreting this law — there was no system of ADR at that time. The general law in a field of civil transactions is the Civil Code of the Russian Federation. According to the Civil Code of the Russian Federation “courts” mean courts (or so-called courts of general jurisprudence), state arbitration courts (also called “arbitrazh courts”) and arbitration tribunals. The problem is that there is no certainty as to whether the definition from the Civil Code is applicable to the law “On consumer Rights Protection”. Also, it should be noted that both courts of general jurisprudence and all the courts are referred to as simply “courts”, that adds to confusion. “A court” or “a tribunal” in European and Russian practice means more than just “a state court”. For example, European Court of Human Rights (ECHR) in the judgement on the case of Campbell and Fell v. the United Kingdom<sup>4</sup> noted that the word “tribunal” is not necessarily to be understood as signifying a court of law of the classic kind, integrated within the standard judicial machinery of the country. In later judgement the case of Lithgow and Others v. the United Kingdom<sup>5</sup> the Court when referring to the Arbitration Tribunal noted that the word “tribunal” may comprise a body set up to determine a limited number of specific issues, provided always that it offers the appropriate guarantees. In the Russian Federation similar opinion is found in the Constitutional Court of the Russian Federation Judgement of

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<sup>2</sup> Web site of the organization <http://arbitrations.ru/>

<sup>3</sup> Law of the Russian Federation “On Consumer Rights Protection” of February 07, 1992, No 2300-1.

<sup>4</sup> Campbell and Fell v. the United Kingdom (1984), ECHR Judgement.

<sup>5</sup> Lithgow and Others v. the United Kingdom (1986), ECHR Judgement.

26<sup>th</sup> of May 2011 No. 10-P.<sup>6</sup> The Constitutional Court of the RF decided that while “court” and “arbitration tribunal” have different meanings in regard to justice (justice may only be provided by a state court) still arbitration tribunal is one of the possible dispute resolutions methods for most civil disputes. As such in law the word “court” may include arbitration tribunals. The other argument against consumer disputes in arbitration is found in the text of the law “On International Commercial Arbitration”. It says that international commercial arbitration may deal with disputes arising of foreign trade transactions and other international economic relations if a commercial entity of at least one of the sides of a contract is abroad. Additionally, in regard to national disputes (as opposed to international) this argument is rendered inapplicable by the latest law “On arbitration” that has the rule that disputes arising from civil law transactions may be resolved by arbitration unless otherwise specified by law, and there’s no rule directly prohibiting pronouncing consumer rights dispute unarbitrable. Unfortunately, at the moment there is still no case-law on this latest law. As to the case-law on the matter before latest amendments it’s quite ambiguous as well. Until recently the Russian Federation had two courts at the top of hierarchy because it has two courts systems, but one of these courts was abolished and its powers were transferred to the one left — the Supreme Court of the Russian Federation. The Supreme Court of the Russian Federation in 2011 stated that legislation had no prohibition to resolving consumer rights disputes in arbitration, so arbitration clause shall be deemed valid as long as the will to use arbitration comes from a consumer after the dispute arises.<sup>7</sup> The Constitutional Court of the Russian Federation supported this opinion when in 2012 it decided that resolving consumer rights disputes in arbitration does not violate the Constitution.<sup>8</sup> But the Higher Arbitration Court of the Russian Federation had a differing opinion and stated that an arbitration clause in any consumer contract is invalid because it always infringes on consumer rights to choose a court and as such any consumer dispute is unarbitrable.<sup>9</sup> As any arbitral award can only be challenged or forcedly executed via claim to a state arbitration court and state arbitration courts follow the opinion of the now abolished Higher Arbitration Court of the Russian Federation in practice any consumer dispute is unarbitrable. New case-law by the Supreme Court of the Russian Federation could potentially change this in future. This leaves us with an interesting conundrum: while no law directly prohibits arbitration in resolving consumer rights disputes arbitration remains unavailable to consumer, because it lacks necessary support by the judicial system. At the same time, it can be said that only national disputes could be resolved by arbitration and international consumer rights disputes are unarbitrable in Russia based on the law “On international commercial arbitration”. It means that these disputes cannot be resolved by any arbitration forum situated in Russia and in case a dispute is resolved in other country an arbitral award won’t be recognized in Russian Federation. As already mentioned, there is no direct and unambiguous clause making consumer disputes unarbitrable in Russia. As such, this rule can be reversed without any changes to legislation if a need is found within new societal rules and trends. In practice though, there are a lot of possible ADR (especially ODR) available to consumers in Russia and some of them are akin to arbitration but still are sufficiently different. The obvious examples include different online trade platforms — Amazon, Ebay or Aliexpress to name a few popular in Russia. All these services include similar dispute resolution system — the service acts as an impartial party to resolve any dispute. Its decision is based on the evidence provided by both parties (seller and buyer), as the conflict includes money paid for items or services the decision

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<sup>6</sup> Judgement of the Constitutional Court of the Russian Federation of May 26, 2011 No 10-P

<sup>7</sup> Judicial Practice Review on the Fourth Quarter of Year 2011, iss. by the Presidium of the Supreme Court of the RF on March 14, 2012.

<sup>8</sup> Decision of the Constitutional Court of the RF of October 4, 2012, No 1831-O

<sup>9</sup> Decision of the Presidium of the Higher Arbitration Court of the RF of September 17, 2013 No 3364/13 on case No A65-15588/2012, Decision of the Presidium of the Higher Arbitration Court of the RF of September 17, 2013 No 6892/13 on case No A79-12504/2012

involves who gets what in the end. So, there are similarities to arbitration or even courts: the decision is issued by a third party who has a power to enforce its decision (as this third person holds the money paid till some predetermined moment of time in case of no disputes or until the dispute is resolved). The only important aspect of this procedure that is different from arbitration is the legal force of a decision issued by a service. This decision does not prevent either party from filing a claim in a proper court and is not legally binding upon parties in any way, but this aspect has to do with legislation and not the nature of a service or a dispute resolution method. There're no regulations on these kinds of dispute resolution method in Russia and that's the only reason there's no legal force behind issued decisions — there could be. Aforementioned leads to inexplicable situation — in online trading the most effective and popular dispute resolutions methods are the ones that are not regulated by domestic law in any way. Clearly legislation is lagging behind the needs of society and modern trends. When dealing with international disputes we encounter a few more difficulties namely the problem of choice of law. The Russian law deals with this problem quite elegantly: consumer can never be left without protection provided by Russian legislation so whatever law is applicable to international consumer contract it has to at least include same guarantees the Russian law has, otherwise guarantees of the Russian law will apply. It means a consumer always enjoys some minimal standard of protection as long as purchase was made in the Russian Federation. Unfortunately this provision may come into conflict with choice of law rules of other countries and as a result give a consumer no protection at all — confused by complex rules a consumer can never be sure what would come of a claim to court and could probably resort to agreeing on unfavorable conditions suggested by a seller to get at least something in case of a dispute without risking losing it all. This problem could only be dealt with by introducing internationally applicable rules concerning consumer disputes, so it is a thing of a distant future — this level of international cooperation is still to be reached by most countries in the world. In contrast to Russia in some other countries arbitration for consumer disputes is possible,<sup>10</sup> though with some limitations mostly aimed to protect a consumer from abuse. For example, arbitration agreement has to exist as a separate document (New Zealand) or can only cover disputes that have already arisen at the moment of conclusion of an agreement (Austria). European Union chooses pro-arbitration approach to resolving consumer disputes. Two documents regulate this field: 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); 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). These documents introduce a complex system of alternative options for resolution and Internet solutions for out-of-court methods.<sup>11</sup> One of the interesting points is how these documents deal with choice of law problems — in a way that is quite similar to Russia. Parties may choose the law applicable to a contract, but such a choice may not deprive the consumer of the protection afforded to him or her through provisions that cannot be deviated from under the law that, in the absence of choice, would have been applicable. In practical terms it means that a consumer can resolve any dispute with a seller or a service provider through a dedicated web-site, choosing whatever venue he trusts — swiftly, from a comfort of his/her own home. Similar system can be established in Russia without any need to changes to existing legislation. As arbitration is always voluntary, it could be enough to just create a platform for dispute resolutions that would allow sellers and service providers to join and offer dispute resolution through online

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<sup>10</sup> Minina A.I. Arbitrability: the theory and practice of international commercial arbitration. Moscow.: Infotropic Media, 2014.

<sup>11</sup> Mania, K. “Online Dispute Resolution: The Future of Justice.” *International Comparative Jurisprudence*, 2015.

arbitration. Prompt and easy way to resolve potential disputes may be enough of an enticement for consumer to choose to deal with those sellers and service providers who have joined the platform. The only problem would be the same as with resolving disputes by Amazon — a decision is not legally binding, so it is dependent upon voluntary execution (even more so, than with Amazon who acts as a kind of escrow). While it can be expected of sellers and service providers for the same reason they participated in arbitration in the first place, voluntary execution cannot really be expected of consumers en masse. This detriment is not really important though, because in consumer disputes in the vast majority of cases a decision does not create any obligations for a consumer, there is nothing for a person to do and execute. Still, obviously new legislation in that area would help development immensely.

#### 4. CONCLUSION

ODR is popular throughout the world and its popularity will only rise with time. As such there is a need to understand and develop legal framework for ODR. While ODR develops even without such legal framework and leads to astonishing results and novelties, the proper legislation can support and help it. European Union aims to unify different states' legislation by issuing appropriate documents. Still this regulation is relatively new and has been fully implemented just recently. Mostly legislators have to follow innovators, it is almost impossible to foresee the future of information technologies — for example there are already talks of implementing blockchain technology in a judicial process even though most countries don't provide any regulation for this technology. As to the Russian Federation, while Russia mostly lacks specific legal framework for ODR the legislation still leaves room for a lot of avenues of development to explore. Lack of legislation is not necessarily the bad thing as it allows more flexibility and lets, in most situations, to achieve the same results without need of state involvement. All systems have something useful and can benefit from appropriating some parts of other states' experiences in dealing with ODR in a globally connected world. Cooperation is especially important because the Internet blurs the borders between countries and makes foreign products and relations with foreign traders available to any person. Modern technologies even allow communication between persons, who do not know each other languages — what other new brave ideas will we see tomorrow?

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## CHALLENGING OF THE COURT SETTLEMENT

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### ABSTRACT

*Disputing parties can conclude an agreement about the subject of the case (settlement agreement) before the court, during the process of the legal proceeding until its definitive end. The Civil Procedure Act does not specify that the settlement agreement can be challenged i.e. it does not predict it to be declared inefficient. On the other side, the academic legal writing and the case law – including different standpoints on the nature of the settlement agreement and its effects – provide different solutions on how to challenge the settlement i.e. how to define its inefficiency. The paper examines the dominant standpoints of the Croatian academic legal writing and its case law concerning the means, reasons and instruments needed for challenging the settlement agreement, i.e. how to declare it null and void. The paper also reviews the legal aspects of these issues in the legal systems in some other countries – member states of the European Union. The paper aims at discovering and recommending specific legislative solutions (de lege ferenda) answering the questions concerning the reasons why the settlement agreement should be challenged, the remedy, time-limit and the moving party demanding to challenge the settlement agreement i.e. to declare it null and void. Good legal regulations are important preconditions for the legal security and the rule of law as a conditio sine qua non in every regulated community.*

**Keywords:** *challenging of settlement agreement, defining the inefficiency of the settlement agreement, legal settlement agreement, reasons and legal instruments for challenging the agreement*

### 1. INTRODUCTORY REMARKS

Court settlement in the Croatian law is concluded according to the provisions of Articles 321 to 324 of the Civil Procedure Act (CPA). It can be defined as an agreement concluded and recorded in a proceeding before the court. By way of a court settlement, the parties entirely or partially regulate their contentious relations which represent the indirect disputed subject matter. It has the capacity of a final substantive court judgement (res iudicialiter transacta) (Pravni leksikon, 2007, p.1553). Dika, similarly, defines the court settlement as an agreement concluded by all or some of the parties and/or potentially third persons based on the (implicit) court approval, during a civil proceeding (litigation court settlement) or another court proceeding (non-litigation court settlement) by signing a court record containing the agreement, whereby its signatories entirely or partially regulate their mutual relations concerning the disputed subject matter and/or deriving therefrom. Said subject matter may have (some) effects of a final court decision or an enforceable instrument, if it mandates a compulsory feascance (Dika, 2013, p. 515). On the one hand, the court settlement is a substantive law agreement, and on the other hand a procedural measure (Grbin, 2007, p. 292). The provisions of the applicable CPA do not prescribe any legal remedies against the court settlement, or that it may be challenged or declared inefficient. However, since the court settlement may also have certain defects, taking into account its combined character (civil law agreement and procedural measure), the legal doctrine and the case law have provided different answers to whether and how it can be challenged. Dika, essentially, finds that the advocates of the dominant substantive law nature of the court settlement equate the possibility of its challenging, in terms of legal means, reasons and deadlines, with the challenging of the civil law settlement, opting thus for the claim and a potential plea as adequate legal means.

On the other hand, those who primarily deem the court settlement as a procedural measure, whose effects conform to those of a final judgement, believe that the court settlement may be challenged by a claim only for the same reasons the motion for a re-trial may challenge the final judgement based on admission and the final judgement based on waiver (Dika, 2013, p. 609). The aim of this paper is not only to present various standpoints on the possibility of abolishing a settlement concluded during a civil proceeding, but also to provide specific proposals to precisely define said institution through legislative solutions. It is aimed at achieving better legal security and providing the parties with a clearly defined civil law protection when the court settlement contains certain legally relevant defects. We believe that, in that sense, every single proposal may be useful.

## **2. LEGAL DOCTRINE**

### **2.1. Earlier Croatian and Yugoslavian legal doctrine**

The provisions of the Court Proceeding Code in Civil Matters (civil procedure) from 1929, the provisions of the Civil Procedure Act from 1956 and the provisions of the Civil Procedure Act from 1976 did not define the legal means and reasons for challenging or abolishing the court settlement. However, the provision of Article 63 para. 1 item 5 of the Execution Procedure Act prescribed the postponement of execution (present-day enforcement), upon the claim for the abolishment of the resolution (present-day settlement), based on which the court has adjudicated enforcement. In the period of application of said Acts, a legal doctrine emerged which predominantly advocated the standpoint that the court settlement, in the absence of explicit court decisions, may be challenged only by procedural means in the pertaining procedure, but not by a claim. Zuglia states that the court settlement has the capacity of a final court judgement, hence he accordingly believes that the court settlement may be challenged only by a motion for a re-trial, for the same reasons as the final judgement based on admission. In fact, he believes that whatever applies to the judgement based on admission should apply to the court settlement as well, as it is the result of the will of the parties to the same extent as the judgement based on admission (Zuglia, 1957, p. 446). Poznić also states that the court settlement has the same capacity as the final judgement, hence it may be challenged by the motion for a re-trial. He indicates that the legal science has a uniform standpoint on this matter, but the case law is divided. He also states that the supreme courts of general competence believe that the procedural court settlement, like the non-contentious one, may be challenged only by the claim in a civil case, whereas the Economic Supreme Court believes that the defects of the court settlement may be rectified only by a re-trial as an extraordinary legal remedy. In terms of a re-trial, Poznić claims that he concurs with the legal science on the standpoint that the court settlement comprises both the admission and the waiver, hence it can be challenged only for the defects that disallow the challenging of these two measures (Poznić, 1970, p. 325). Triva states that, despite the plausible uniformity of the judicatory which advocates the opposing standpoint, it would be more correct from the standpoint of the Yugoslavian civil procedure law to believe that the court settlement may only be challenged by (some extraordinary) procedural means. He, furthermore, claims that the court settlement cannot be challenged by a regular legal remedy, because it has the same capacity as the final judgement, whereas it would be out of the question to return to the previous status, since the presence of both parties presumes the conclusion of the settlement. In addition, the challenging of the court settlement by extraordinary legal remedies should not be allowed within the same framework as the challenging of the contradictory judgement. Since the character of the court settlement is closest to the judgement based on admission, the court settlement should not be challenged to a larger extent than this judgement by extraordinary legal remedies (Triva, 1986, p. 476 and 477).

## 2.2. Recent Croatian legal doctrine

We have indicated in the introductory remarks that the court settlement is defined in the Croatian civil procedure law by the provisions of Articles 321 to 324 of CPA. These provisions, as well as aforementioned civil procedure acts, do not prescribe legal means, methods or reasons for challenging the court settlement or declaring its inefficiency. On the other hand, the provision of Article 65 para. 1 item 4 of the applicable Enforcement Act from 2012 prescribes that enforcement shall be postponed upon the proposal of the enforced party if a claim has been filed for the abolishment of the settlement granting enforcement or a claim for the establishment of its nullity. There was a same provision in the earlier Enforcement Act from 1996. During the applicability of said CPAs and enforcement acts, views were presented in the Croatian legal theory regarding the method and the reasons for challenging the court settlement, which we categorised under recent Croatian legal doctrine for the purposes of this paper. Jelčić indicates that, considering that the court settlement has the same procedural capacity as the final court judgement, it cannot be challenged by regular legal remedies. She does not express her own viewpoint on the method of challenging the court settlement, but she does, however, notice the divided opinions on whether a re-trial may be sought against a court settlement. She also states that the judicatory assumes a uniform standpoint that the court settlement may be challenged only by a claim due to procedural and substantive law defects, and not by the motion for a re-trial (Jelčić, 1996, p.177 and 178). Triva states, similarly to his previous contemplations, that in spite of the plausible uniformity of the judicatory which advocates the opposing standpoint (according to which the court settlement is challenged by a claim), from the standpoint of the earlier Yugoslavian and present-day Croatian civil procedure law it would be more correct to assume that the court settlement could be challenged only by some extraordinary procedural means (Triva, 2004, p. 576). Grbin observes that the issue of rectifying defects underlying the court settlement has become rather complex in the legal literature considering the combined characteristics of the settlement as a civil law agreement and a procedural measure with certain procedural effects. In that sense, he claims that the present-day Croatian judicatory has solved this issue. He, essentially, claims that the party who believes that the court settlement has defects affecting its validity may resort to a claim for the annulment of the agreement or the establishment of its nullity, but not to an appeal or a motion for a re-trial (Grbin, 2007, p. 298 and 298). Jakelić, deriving from the substantive law character of the court settlement, which he deems a specific civil law contract, believes that it can be challenged or declared null only by a claim. He explicitly states that the court settlement cannot be challenged by an appeal, motion for a re-trial or review (Jakelić, 2016, p. 70). Unlike him, Nakić sides with the theoreticians who believe that the court settlement may be challenged by the motion for a re-trial. He claims that there is a justifiable question in the theory as to why, for instance, the final judgement based on admission can be challenged by the motion for a re-trial, and the court settlement cannot, if they both depend on the sheer will of the parties. In support of his standpoint that the court settlement should be challenged by the motion for a re-trial, he indicates that if such challenging method were not allowed, it would mean that the court settlement superseded the judgement, which is not the legislator's intent (Nakić, 2002, p. 4). Upon an exceptionally comprehensive and detailed analysis of the issue of establishing inefficiency of the court settlement and its challenging, Dika nominally claims that *de lege lata* the claim is a legal means for challenging the court settlement in sense of Article 65 para 1 item 4 of the Enforcement Act from 2012. He, furthermore, states that the claim could be filed only for the same reasons as the motion for a re-trial is filed for challenging the judgement based on admission and the judgement based on waiver. However, in his view, this claim could not seek the establishment of absolute nullity of the court settlement, and the court settlement could not be challenged for the reasons of contestability other than for the defects of will. Dika bases his standpoint that the court settlement *de lege lata* should be challenged by a claim, in addition to said provision of Article



65 para 1 item 4 of the Enforcement Act from 2012, also on the provision of Article 36 of the Arbitration Act (Dika, 2013, p. 624). Said provision, inter alia, prescribes that the claim for annulment cannot be filed against the judgement of the arbitration court in conformity with the provisions of this Article, and that no other legal means in court are allowed against the judgement.

### **3. CASE LAW**

As we have already mentioned above, the applicable case law has a uniform standpoint that the court settlement may be challenged only by a claim due to procedural and substantive law defects, and not by extraordinary legal remedies, in particular the motion for a re-trial. In that sense, we provide the following examples of the judicatory:

1. The Supreme Court of the Republic of Croatia in the judgement Rev 3182/1993-2 of 21 December 1994 denied the respondent's review as unfounded. It is evident from the rationale of this judgement that the second-instance court judgement dismissed the respondent's appeal as unfounded and upheld the first-instance judgement which annulled the court settlement on property distribution concluded before the Municipal Court in Stari Grad on 7 December 1987. The Supreme Court stated that the first-instance and the second-instance court validly applied the substantive law when they complied with the claim.
2. County Court in Varaždin in the decision Gž 989/2003-2 of 20 October 2003 clearly stated that the settlement is, in essence, a civil law agreement whereby the parties autonomously regulate their contentious relations or a part thereof, hence none of the parties is entitled to an appeal against the court settlement. It is indicated in said judgement that the parties may challenge the legal validity of the settlement by a claim if the legally prescribed requirements for the conclusion of the settlement have not been met.
3. On 5 October 2016, the County Court in Varaždin in the decision under file No. Gž-510/16-2 stated that the court settlement may be challenged only by a claim within three years of its conclusion. In fact, the County Court believes that the claimant's right to seek the annulment of the contested contract has terminated upon the expiration of the three-year period from the conclusion of the court settlement (Article 335 para. 2 of the Civil Obligations Act).

### **4. FOREIGN LAW**

#### **4.1. Germany**

Dika observes that the statutory regulation of the court settlement in the Croatian law is substantially more elaborated than in the German law. In that sense, he stated that the German law, in fact, contains a single provision on the settlement (Dika, 2013, p. 518). Indeed, the provision of Article 794 of Zivilprozessordnung prescribes that enforcement may be mandated based on the settlement concluded between the parties or between one of the parties and a third person for the purpose of terminating the dispute entirely or regarding a part of the disputed subject matter and based on the settlement concluded according to the provision of Article 118 para. 3 of Zivilprozessordnung (settlement concerning the approval of assistance in the compensation of the procedural costs), and according to the provision of Article 492 of Zivilprozessordnung (possibility of reaching the settlement in the evidence gathering procedure) (Baumbach, 2017, p. 2256). It derives from the German doctrine and judicatory that the court settlement in the German law may be declared null and challenged (Baumbach, 2017, p. 1394-1403). Dika concludes that if (during proceedings) it is established that the (contested) settlement is efficient, the judgement should confirm that the dispute has been resolved, and the civil proceeding terminated. On the other hand, if the judgement establishes that the court settlement is inefficient, the case (in which the inefficient settlement had been reached) should proceed (Dika, 2013, p. 619 and 620).

#### **4.2. Slovenia**

Unlike the Croatian and the German procedural law, the Slovenian procedural law explicitly provides the possibility, reasons and assumptions for challenging (dismissing) the court settlement by a specific claim prescribed by the provisions of Articles 392 and 393 of *Zakon o pravdnem postopku* (Civil Procedure Act). The provisions of Article 392 of *Zakon o pravdnem postopku* list specific reasons for challenging (dismissing) the court settlement. These reasons extensively correspond to the reasons for a re-trial, and include deception, coercion, fraud, participation of a judge in the settlement conclusion who should have been recused or has been recused by a court decision, participation of a person who cannot be a party in the proceeding, unlawful representation of the legal entity, illicit representation of a party without legal capacity, if the attorney acted without the power of attorney, unless it was subsequently granted. The provision of Article 392 para. 2 of *Zakon o pravdnem postopku* prescribes that the claim for challenging (dismissing) the court settlement may be filed within three months from the day the party was notified about the reason for challenging (subjective deadline), whereas the provision of paragraph 3 thereof defines that the party, upon the expiration of the three-year period from the conclusion of the court settlement (objective deadline) is no longer entitled to file the claim.

#### **5. PERSONAL STANDPOINT - DE LEGE FERENDA**

Court settlement is an agreement with substantive law and procedural law component, which has the legal effect of the final judgement. We side with those who, in the Croatian legal doctrine, advocate the dominant substantive law character of the court settlement and equate the possibility of its challenging in terms of legal means, reasons and deadlines, with the challenging of the civil law settlement, opting for a claim and possibly a plea as adequate legal means. On the other hand, the theoreticians who deem the court settlement primarily as a procedural measure, whose effects are equated with the final judgement, believe that the court settlement may be challenged by a claim only for the same reasons as the motion for a re-trial challenges the final judgement based on admission and the final judgement based on waiver. There are also authors (although to a lesser extent) who advocate the motion for a re-trial as a legal means for challenging the court settlement. We believe that between the substantive law and the civil procedure component of the court settlement, the vantage is given to the substantive law component, because the court settlement is primarily an agreement. We believe so because its conclusion is based on the will of the parties in the civil proceeding, whereby the role of the judge, before whom such settlement is concluded, is secondary. In fact, it is his/her role only to monitor if a specific settlement is legally valid, which is certainly important, but it does not represent the fundamental – dominant characteristic of this legal institution. On the other hand, it is evident that the court settlement, due to the measures undertaken by the parties leading to its conclusion, bears clear and unequivocal resemblance to the judgement based on admission and the judgement based on the waiver. In view of the above, we believe, i.e. side with the standpoint which perceives the claim as a legal means for challenging the court settlement. The claim seeking annulment or abolishment of the court settlement should be based on the reasons allowing the repeating of a trial concluded by a judgement based on admission or a judgement based on waiver. We concur with Dika who believes that, in terms of reasons and deadlines for challenging the settlement, the legal system could resort to aforementioned solutions adopted by the Slovenian law (Dika, 2013, p. 626). However, we also believe that only a claim could seek the establishment of nullity of the settlement for the reasons stated in the provision of Article 322 of the Civil Obligations Act. The lawsuit containing such a claim (for establishing the court settlement as null) could be filed by any interested party, as well as a state attorney, in conformity with the provision of Article 327 of the Civil Obligations Act. In any case, regardless of the standpoint we support in terms of challenging the settlement, it

would be of the utmost importance that the legislators incorporate the institution of the court settlement into our CPA (which can be modelled after the Slovenian model with certain modifications), because clear and structured regulations are the basic requirement for legal security.

## 6. CONCLUSION

Illicit decisions – first-instance judgements jeopardise the objectives of the rule of law, primarily its legality and equity, and such decisions adversely affect the trust of the parties in the judicial system. Therefore, modern legal systems, like the Croatian system, provide the rectification of court errors and irregularities through legal remedies, primarily an appeal. However, the court settlement, whose procedural effects correspond to those of the final court judgement, can also have certain procedural and substantive law defects for which it should be annulled, abolished or declared null, if these defects are particularly important and substantial, in order to protect the generally proclaimed principles of legality and equity. CPA does not define the challenging of an illicit court settlement, but the legal doctrine and judicatory provided numerous different answers to the questions regarding the means, methods and reasons for the challenging of a court settlement. However, we believe that without regulating the institution of challenging the court settlement by clear and specific provisions in CPA, it is not possible to entirely realise the legal security of the citizens in this legal area, and consequently the rule of law which is a *conditio sine qua non* of every regulated society. In that sense, in this paper we have attempted to propose some specific solutions because we believe that each slightest attempt contributes to the development of law and clarification of legal notions.

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## GLOBALIZATION AND NEW SOCIO - ECONOMIC PROCESSES

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### ABSTRACT

*Globalization brings new theoretical problems, new socio-economic processes and also increases the demands on the specific qualities, abilities and performance of individuals and society as a whole. Knowledge and scientific knowledge are an important attribute of the present era, which increases the importance of human capital development. Each of us has an impact on the lives of people around the world, and people in other parts of the world are also influencing our lives. In order to better know these connections and to be able to positively change the environment around us and the whole planet, it is essential to innovate all forms of education so that the acquired education is a prerequisite for ensuring a quality life. Based on the results of sociological research, insufficient education makes it impossible to get better work and thus a higher standard of living. People with lower education buy statistically unhealthy food, which is cheaper, have a demanding manual job, and are often unable to provide quality housing that allows personality development. People who have just the knowledge they need to live their lives can fulfill their lives by doing what they want to achieve. However, if they live in a society where higher education is a vision for a better life, the educational factor has an impact on overall quality life. The contribution focuses on the analysis of the level of education, the level of income and the possibility to live in the Slovak Republic in the context of global differences. The level and differentiation of employees' salaries in the context of globalization processes has been a problem for a longer time. Inadequate income make a polarization within society, degrades the behavior of households, their economy, and consequently the economy of public institutions, the functioning of organizations and the entire economic system. As the real estate prices do not coincide with local revenues in the economy, the real economy is exposed to credit-deformation distortions, which has an impact on the distortion of financial flows.*

**Keywords:** Education, Human capital, Migration, Quality of housing

### 1. INTRODUCTION

*"Globalization is a multidimensional process in which the tendency towards increasing interdependence of political, economic, social, environmental, technological and security phenomena and processes is being promoted across the globe."*

*Šikula (1999)*

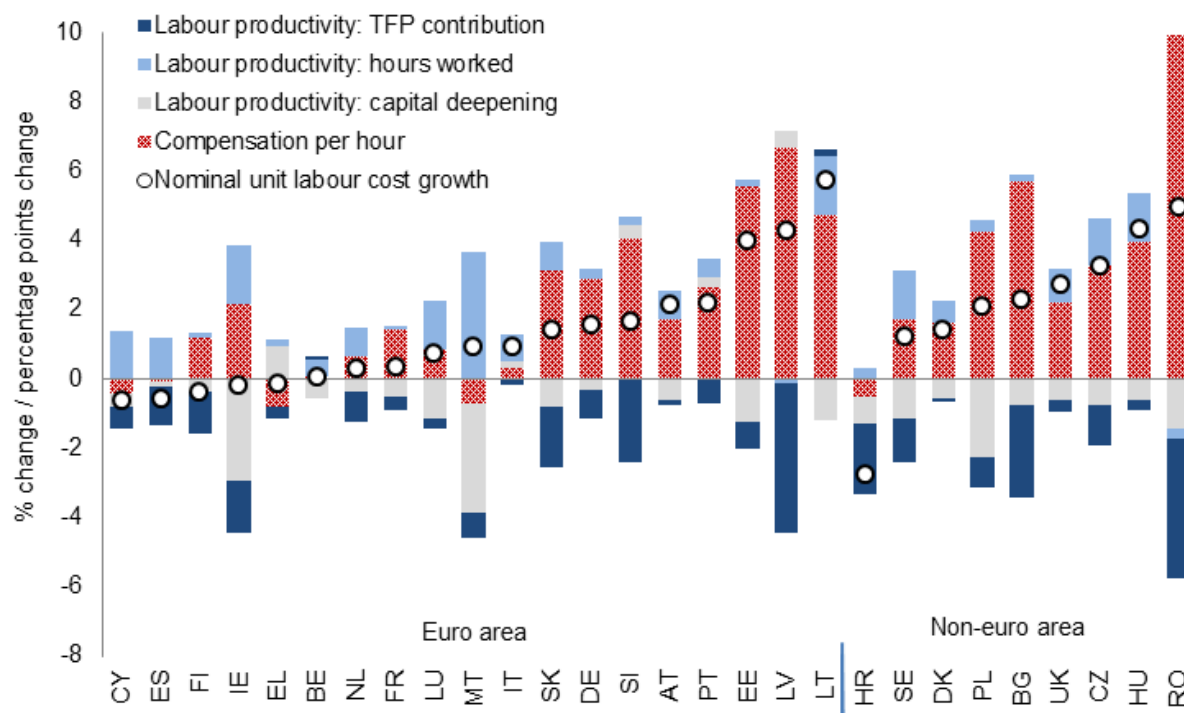
Globalization has been part of observation in Europe in the 1970s. Its origins have been influenced by Spanish and Dutch voyagers and merchants, and thanks to them, their mother countries, same as from Britain and Portugal, have become the first global powers. The adoption of the Gregorian calendar contributed to gradual interconnection of the world and the overall unification of the date and time zones between 1875 and 1925. Globalization is one of the most important part of modern human history, with the world becoming increasingly aware that our planet is ever smaller and resembling a spider network where even the smallest movement in one place will resonate the entire network, and the number of activities and departments that are influenced by the global nature of the world. More and more people are getting into the process of globalization. Globalization brings new theoretical problems, leading experts to re-evaluate current theoretical concepts and views of society and socio-economic processes.

Many authors (Bendl, 2001, Bertalanffy, 1972, Ivanička, 2000, Toffler, 1996, Lysák, 1997, Samuelson, 1998, Pike, 1994) have mentioned this in their work. In the process of globalization, national unity and its actors, national and transnational relations, new identities, social spaces, social states and processes are overlapping. Toffler (1970), in his work *Futurc Shock*, states that the power of the global system is growing and the information media is interconnected into this global system. Electronic Infrastructure has seen through active interaction - a TV set connected to a computer when a player or viewer communicates; Mobility - car phone, portable video with computer, phone in wristwatch; convertibility or direct transmission of information from one medium to another, such as word-printed words; the interconnection of suppliers of goods and services is standard throughout the world; not only for the rich, but also for the poor and globalization, as a global flow of knowledge and finance that crosses national borders. A. Giddens (1990) defines globalization as "an intensification of social relations at a global level that leads to the interconnection of very remote sites in such a way that local events are shaped by events going away miles away and vice versa." The world shrinks and what it does on one side of the globe, it can affect the process of the other. According to Gray (2002), globalization is a historical process that is based on the unequal economic level of individual states of the world. The growing connectivity of the world economies may be due to differences between regions, states and their localities. Globalization, global markets and global players thrive due to the differences between the economies of the world. The main problem of defining the notion of globalization by Holton (2011) is that it has become an overwhelming expression for many different social changes. Globalization processes are currently affecting political, economic, social and cultural changes not only globally but also at all lower levels. The essence of globalization lies not only in the creation of the global environment itself (in economics, trade, production, culture, transport, politics), but also in the creation of new relations between global and regional, national and international.

## **2. GLOBALIZATION, PRODUCTIVITY OF WORK**

Globalization is currently linked to low labor productivity, low inflation, aging populations, and global debt growth. The main source of competitiveness is productivity, which is currently significantly influenced by innovation. Productivity plays a key role in raising living standards. This applies in particular to long-term and, above all, to the overall productivity of factors, to the overall efficiency of the EU economy by using capital and labor. Enhanced efficiency helps to create more goods, but also frees resources that can be used to produce other new goods and services, replacing jobs and creating new ones. The steep decline in productivity has occurred at the time of the global financial crisis and has not increased since then. Growth of labor productivity through the modernization of industrial manufacturing activities is currently largely exhausted, thus increasing production is reflected in employment growth and consequently wages as labor productivity. When comparing labor productivity in Poland, Czech Republic, Slovakia, Hungary and Croatia, labor productivity is the highest in Slovakia, but in Slovakia there is the lowest wage among these countries. The Czech Republic and Hungary have a higher tax-insurance burden than Slovakia, fewer people work there during the night and on Sunday. Slovaks spend 28% more time each year on the Germans. Taking into account the price level in both countries, it shows that labor productivity in Slovakia is 79% of Germany, Slovakia's GDP is 62% compared to Germany, but the labor costs in our country are 37% compared to Germany. After taking prices into account, in Slovakia we have the highest prices in the V4 region compared to the wages, and are also lower in Croatia, which joined the European Union only in 2013. The reason is the unfair distribution of the wealth generated between employees and employers.

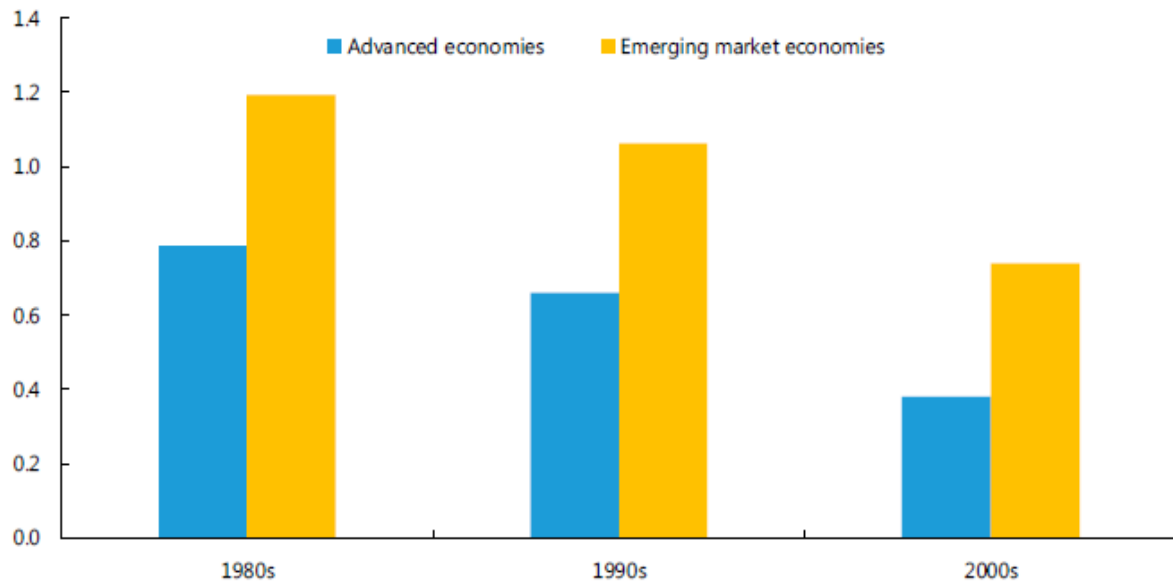
*Figure 1 : Growth in unit labour cost and decomposition of factors, 2016 (AMECO and Eurostat. Commission services calculations)*



While in Western countries, 55% to 65% results of employees work is paid to workforce, only 44% results of employees work is paid to employees and 56% to the companies in Slovakia. As a result of this distribution, Slovakia has an average wage of € 912, and in Slovenia, where the value is distributed to employees more fairly, the average wage is € 1700. Labor productivity is as big as in Slovenia. Average hourly labor costs in the EU is amount to € 23.1. The highest hourly labor costs in the EU are in the Benelux countries (€ 39-44) and Denmark (€ 42). Above average hourly labor costs also account for the largest euro area economies - Germany and France, around € 33 per hour. On the contrary, somewhat lower labor costs are in the south of Europe - from € 11 in Portugal to € 22 in Italy. Compared to the cost of work at the level of 9.70 € per hour in the Czech Republic and Slovakia, higher labor costs within the region of Central and Eastern Europe are only in Estonia (€ 10.90) and Slovenia (€ 16.40). In Bulgaria and Romania, labor costs are only around € 5, and below average, compared to other countries in the region, they are in Poland of € 6.5 and € 7.4 in Hungary.

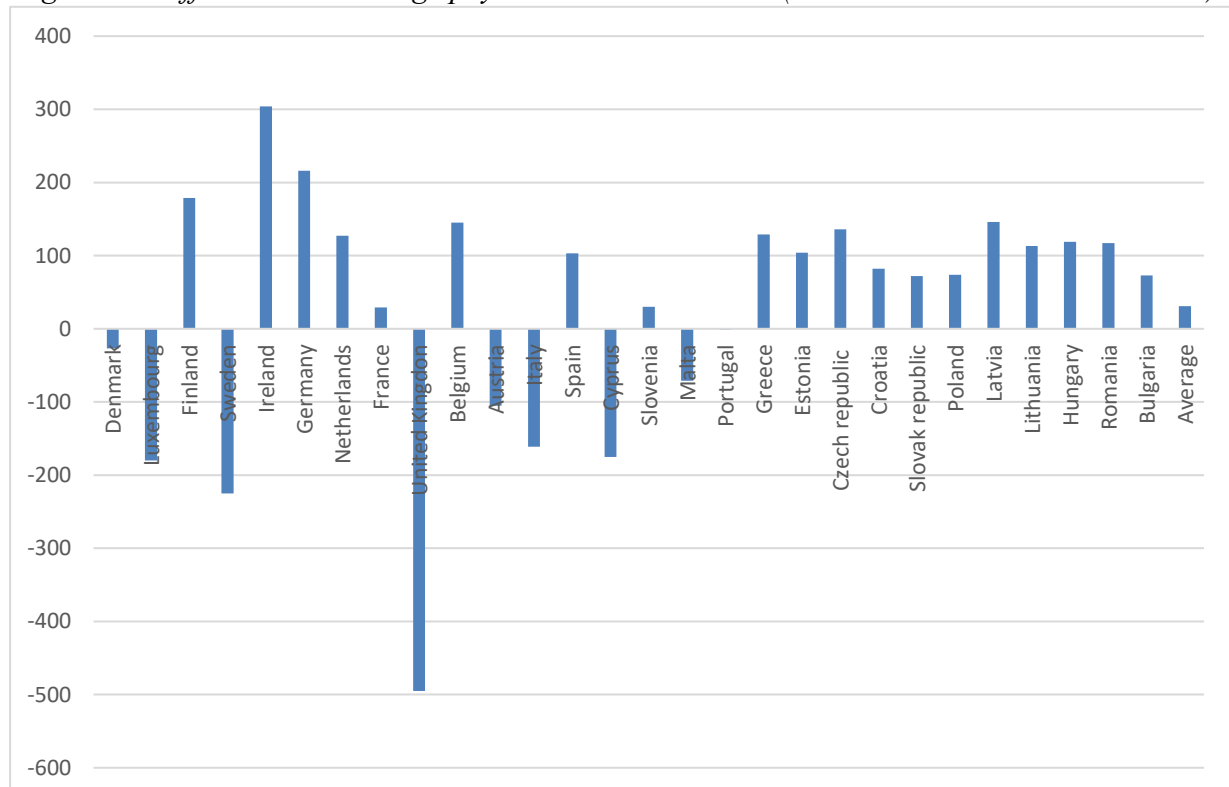
*Figure following on the next page*

Figure 2: Contribution of human capital to the growth of labour productivity v % (Martin and Morison, 2013)



In terms of average wages in the European Union increased by around 2.02% compared to 2014. The average wage in the EU countries for 2017 is € 1,520 per month, compare to € 1,489 in 2014. The country's highest average wage is in Denmark (€ 3,095), currently higher than in Luxembourg (3,009 e). In Scandinavia, Finland is € 2,509 and Sweden € 2,468. Germany is ranked sixth, with salaries increase of € 216 in four years and at the level of € 2,270. At the opposite end are Bulgaria (€ 406), Romania (€ 515) and Hungary (€ 622). In Slovakia, the average salary is 925 € and in the Czech Republic 1141 €. In Western European countries, salaries increased by €136 in last three years. (Figure 3)

Figure 3 : Differences in average payments 2017/2014 in € (own calculations- data Eurostat)





The UK, which remains a member of the EU at least until March 2019, saw a decline in average wages compared to 2014 by as much as € 495 and today the country's average wage is € 2,102. The average wage in all countries of the European Union is € 1,520, with more than 4,000 people working in fourteen countries: Denmark, Luxembourg, Finland, Sweden, Ireland, Germany, the Netherlands, France, the United Kingdom, Belgium, Austria, Italy, Spain and Cyprus. The average monthly salary in Switzerland is € 4,908 and in Norway € 3,369.

### **3. BUSINESS EDUCATION AS A PREPARATION OF MOTIVATION**

Productivity is influenced by human capital and the quality of its education. The theory of human capital was developed in the early sixties of the 20th century. Human capital can be characterized as a sum of the innate and acquired abilities, knowledge, experience, habits, motivations, and energies that people have and which can be used to produce products over a period of time. Human capital is a production factor that delivers a specific character to the enterprise. The term human capital into general economics was introduced by Milton Friedman when he divided his wealth of human capital and other capital into his analysis of money demand. For human capital it considers the knowledge, habits and abilities of a person to work. Raising this knowledge, habits and abilities is associated with some human investment in human capital. Under conditions where man is the main productive capital and creator of values, his status, role and economic development change. Under the conditions of globalization, man becomes the main and the only important source of economic production, distinct from his secondary position in terms of industrial production. In their work, one can use certain production machines and equipment, such as computers, laboratories, test facilities which are not essential in creating new knowledge. Analyzes of the nature of human capital at this time have also made the issue of the economic and social aspects of reproduction and human capital formation in society and the rule of innovation work very important. The growth in unit labour costs in a number of net-creditor countries (Denmark, Germany, Luxembourg, the Netherlands and Sweden) remained overall moderate in 2016, having cooled somewhat in Germany against the backdrop of subdued wage dynamics, despite the tightening labour market. It is well known that education plays an important role in the process of innovation. At the same time, according to A. Marshall, long-term investment in education is needed to create the human capacity to generate innovation. The individual in this case decides on the basis of the relationship between the length of education and the amount of expected education income (Marshall, 1962, p.245). And when an individual decides in favor of a long-term investment in education and expected earnings, it requires education from the people who earn the funds. The subject of interest in the context of the globalization process is currently education, as it is a process of conscious learning of scientific and general knowledge and context, intellectual and practical skills and development of human potential. Supporting education, whether from a moral, financial or material point of view, should reflect the importance of this process for the whole of society. (Orbánová - Velichová 2016). As education helps to develop personality, the development of society as a whole, it helps the development of humanity, the development of civilization, the transfer of cultural values. According to Toffler (1970), knowledge is fundamentally revolutionary, because it can also be used by the weak and the poor, is therefore the most democratic source of power, as a result of which the proletariat changes to cognitive. This makes knowledge a permanent threat to the powerful, even if they are just trying to increase their power through them, since every power-holder wants to control the distribution of knowledge in his sphere of influence. In the most advanced countries, regardless of inequality in income and wealth, power will be fought in the area of access to knowledge. The capitalization of human resources means the possibility of training and retraining of human resources. Even if an individual is going through a learning process and is ready to enter the labor market, it is essential to continue learning, and every organization that wants to achieve

quality growth is trying to provide the opportunity for further enlightenment. According to Vodák and Kucharčíková (2011), employee training is beneficial for the company as well as for the employee himself. It enables him to form work skills, improves his / her qualification, level of education, acquires new skills, increase the expectation of higher job evaluation. The company thus increases its attractiveness, improves quality and market price. It helps to improve working relationships. Education must be implemented systemically as says by Czikk and Čepelová (2006). This is an increase in the cost of the business, but these will come back several times in the form of better performance. Therefore, when choosing an employment, it is also possible to verify whether an enterprise is interested in educating its employees. The issue of the educational process and its need is also the subject of many authors. According to Vetráková (2007) there are two areas of education, acquisition of skills and development of an employee. In the context of qualification training, it is about acquiring the specific knowledge and skills necessary for the proper performance of the work for which it has been admitted, training when it comes to continuing vocational training in the field in which one is working. Usually it is about adapting the employee to new demands due to changes in technology, product innovations, materials, processes. Another author Horník (2007) lists other types of education, such as functional education, supplementary education, managerial education, language learning, IT training (Table 1).

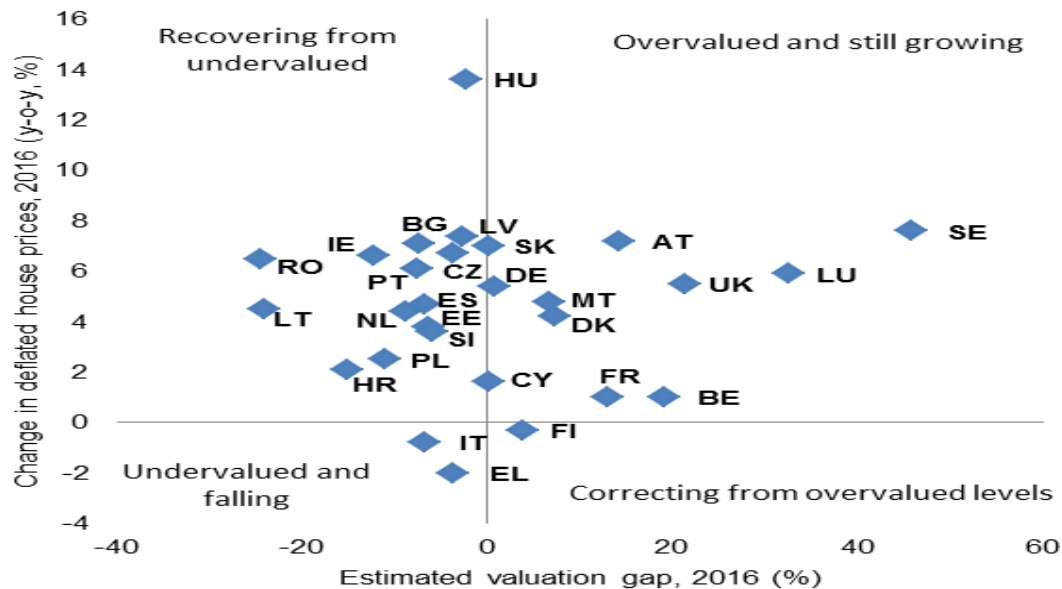
*Table 1: Types of education (Horník, 2007)*

Learning Area	Time Context	
	Within the workplace	Outside the workplace
Functional education	Rotation	Lecture
Additional functional education	Rotation, project work	Project management course
Managerial training	Individual coaching, mentoring	Leadership
Language Education	Stays at Foreign Branch	Corporate Courses
IT training	Creating a presentation in PP	Training in creating presentations
Shared education	Shading	Time management, outdoor training
Training by law	Instruction	Work safety training

The learning process has its goals. The objectives of corporate employee training are to increase the level of their knowledge and skills and to change their professional behavior in order to reduce the difference between the characteristics of the employee and the requirement imposed on him. One way to reduce this difference is to implement training sessions, or educational programs. Another objective is to ensure the high professional level of each worker by shaping work skills and shaping the personality of the worker and the social characteristics that affect the behavior, consciousness and motivation of the worker and reflected in the interpersonal relationships at the workplace. Employee training requires a quality education system. Results cannot be seen in the short term. They are visible from an objective point of view in the employee's performance itself, but also subjectively, when a joint-ventured person spreads the good name of the company, and this may be reflected in the interest in work. This is a significant factor in the present, when unemployment in Slovakia at the historical minimum. Companies simply have to motivate people to go to work in their company or vice versa to stay in their business. The average number of bidders responding to one offer decreases.

Companies are therefore trying to reduce fluctuation and increase the satisfaction of their employees by raising salaries, but also offering various benefits.

Figure 4 : House prices changes and valuation gaps in 2016 (Eurostat, ECB, BIS, OECD and Commission services calculations)



The emphasis on raising the educational level persists. It is a prerequisite for entering the labor market, higher earnings, and also the assumption that the employee becomes a part of the investment process and joins the real estate market as there is no possibility of renting a home. (Vidová - Sika, 2017). In the real estate market, the state of the employment was reflected, as real estate prices grew in 2016, not only in Slovakia but also in 25 Member States, in Bulgaria, the Czech Republic, Ireland, Latvia, Hungary, Portugal, Austria, Romania and Sweden. In some Member States, the persistent dynamics of residential property prices is linked to the provision of mortgage loans, indicating the risks of overdraft caused by credit. This is particularly true for Romania and Slovakia, where mortgage credit growth exceeded 10% in 2016, albeit in the context of a low level of household indebtedness. Overall, the significant increase in residential property prices in some EU countries requires continuous monitoring of the possible accumulation of macro-financial risks and its implications as regards the allocation of resources and the affordability of housing. The rise in real estate prices on the Slovene bank is a significant and rational volume of loans for the purchase of residential real estate, which contributed to a growing tendency in terms of the private sector debt ratio.

#### 4. CONSLUSION

In the paper, we have devoted to the globalization process, which influences all areas of life. Based on available data, we can conclude that inequality between incomes raises various social and economic problems. Inequalities are caused by uneven distribution of profits, uneven remuneration for the work done, uneven use of technology, In the case of inadequate incomes, they do not have sufficient social flourishing, which negatively affects work performance as well as personality development. Globalization is a process that has already been irreversibly started and must therefore be accepted as a fact, with all the innovations and problems that come with it.

Country governments must respond to ongoing globalization and ensure a higher standard of living for their citizens, as the level of competitiveness of the economy depends on it as well. One important area is education, because only a higher level of education can increase wealth in countries.

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## PROMISING METHODS FOR ASSESSING THE WELL - BEING AND QUALITY OF LIFE OF PEOPLE IN DIFFERENT REGIONS

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### ABSTRACT

*Background In our opinion, quantitative methods of assessing the wealthy level of population cannot determine the quality of life of people; different modes to measure happiness and well-being show results that are not the same with those of the quantitative assessment. In this way, differences about life conditions in macro-regions, including several countries of similar economic development and traditions are important; another important aspect is the regional differentiation of the standard of living within the state, including the processes of urbanization. Complete measuring well-being and quality of life can be represented by taking in consideration the peculiarities of a person's perception of their situation; moreover, is necessary to take into account the conditions created by public environment and infrastructure. Method In the article, based on an analysis of various approaches to measuring social welfare, we suggest a methodology that allows us to appreciate the well-being and quality of life of people. For this reason, we are considering the possibility to make a comparative assessment of the well-being of macro-regions and micro-regions, with a new criterion, which reflected comfort and life satisfaction. Findings Looking at studies of various approaches to assessing of standard's life, it is revealed that financial performance does not fully and not always correctly reflect the real perception of their well-being by people. The inaccurate reflection of this information may distort many decisions and recommend measures about the government regulation; an examination of migration movements can also provide an opportunity to better assess the perception of the level of well-being and potential opportunities. Improvements Representatives of different regions base the consideration of criterion in assessing the quality of life on the study on the contribution of the level of comfort to the perception of well-being, so the formation of a system of indicators of comfort may assess level of well-being and its impact on the quality of life.*

**Keywords:** *Harmonious Development, Macro-Regions, Micro-Regions, Quality of Life, Well-Being*

### 1. INTRODUCTION

The interregional assessment of the quality of life and well-being as well as the problem of convergence of regions by criteria for detailed analysis, acquires special importance in the current circumstances. The conception of well-being in economic science has been a rather long period of development that create many definitions about this phenomenon. In our study, we stick to the economic approach to well-being as necessary components for a full life of people and the feeling of comfort. In modern researches, frequently carried out adjustments to already existing indicators that affect the well-being of people. Traditionally, are considered two types of societal costs, which appear at low stages of development: ecological (pollution of the environment, promotion of the economy of careful consumption of resources) and social (growth inequality). Moreover, in some studies, preference is given to welfare adjustments by the level of inequality, in other by the level of emissions to the atmosphere of harmful

substances. Comprehensive assessment of well-being considering these and other effects of development was proposed by Daly and Cobb in the form of the index of sustainable economic welfare (ISEW) which turned into the Genuine Progress Indicator (GPI) after some changes. (Daly, Cobb. 1989). In several works it is possible to find calculations of the welfare of countries and regions based on these indices. After calculating the indicators, foreign researchers conduct a comparative analysis of ISEW and GDP (Porcu, 2010). The report of the Commission, chaired by Joseph E. Stiglitz, Amartya Sen, Jean-Paul Fitoussi, is the most recent and important attempt to calculate better measures of economic performance, taking into account the quality of life and the sustainable development (Stiglitz et al., 2009). Russian economists also attempted to build a synthesis of ratings of regions based on human development indices and quality of life in all regions; some scientific articles are devoted to the definition of welfare considering the socio-ecological component of development. Actually, there are different works that use the simplified welfare Am. Sen's function for the assessment of social well-being. (Malkin M. Yu. 2017 pp.49–62) ) The advantage of such methods is the ease of calculations, but the main drawback is the very narrow criteria of comparisons and great importance is attached to indicators of GRP and GDP. In our view, the expansion of the components of the assessment allows for more comprehensively evaluate the quality of life of the population in certain territories. Am. Sen investigated the concept of human freedom, he suggested to depart exclusively from the material side and considered that any possibility of choice contributes to the manifestation of human freedom. In addition to freedom, it is necessary to consider opportunities to realize the potential of personal development. «The good life» is based not only on the benefits we use directly but also on the instrumental values, which create opportunities; moreover, aesthetic and other intangible values influence our standard of living. It is important to note that the main advantage of increasing the number of indicators of well-being or quality of life of the population is the ability to divide the indicators into categories of welfare, to develop methodologies that enable the analysis to reach more significant values, sociological data and experiments, thus comprehensively approach to the evaluation. In our opinion, ensuring a high quality of life is a primary objective of the development of the region leading research organizations of Russia and the world have not developed a unified approach to the assessment of well-being and quality of life. To address the problem it is necessary to conduct analysis at different levels of the region, therefore, we suggest the notion of «region» be divided into micro and macro-regions. The term «macro-region» we mean convergent territories, with similar economic problems, resource, and industrial potential, which are at the same economic, political and financial levels of development. The macro-region is a single economic space consisting of dynamically developing elements such as micro-regions, which have their own peculiarities. The main objective of the study is to compare the macro-regions on the components to identify the priority direction of sustainable development for each. Quality of life is a broad notion that could be interpreted, as the conditions and degree of satisfaction of a wide range of material and non-material needs, which are expressed in quantitative and qualitative consumption of material and spiritual goods, realized in the field of consumption. Among these needs are food, clothing, housing, work, leisure, safety, education, medicine, etc. In addition to objectively existing requirements on the quality of life, it is affected by the subjective perception of the degree of satisfaction of needs, and the needs of personal freedom and self-realization. On the one hand, the quality of life is adversely affected by population density, quality of food and degree of environmental pollution; on the other hand, the quality of life is also determined by the level of wages, living conditions, and other economic factors. There is a reverse trend in which, the higher the level of industrial development and national income per capita, i.e. the better the economic indicators, the greater the density of resettlement and the level of environmental pollution, as a result, the ecological component of the quality of life is deteriorating.

Therefore, the quality of life can be determined by different indicators: economic, ecological, physical, psychological, medical, sociological, which do not always act in one direction. Therefore, the choice of indicators reflecting the level and quality of life should be approached with special thoroughness.

## 2. METHODOLOGY

The assessment of well-being and quality of life is carried out based on separate indicators, they include components of economic infrastructure, which are characterized by household final consumption expenditure. This component consists of consumer expenditures incurred by residents of households for individual goods, services, and rent. We consider that average monthly household expenditures in contrast to an average monthly net salary more accurately reflects the level of well-being of citizens. The economic infrastructure also includes a net migration, unemployment, and transport infrastructure; the block of social infrastructure consists of education, cost of utilities, the price for the rent of the apartment, health care, safety. We consider the block of ecological infrastructure as an element of sustainable development, appreciate the macro-regions according to the index of environmental pollution and waste recycling opportunities in their territories. In the framework of the method to calculate the indicators used data of United Nations Statistics Division (UNSD), The World Bank Group, World Health Organization, Numbeo.com. The research of the quality of life macro-regions and the identification of the most significant components is based on the allocation of 15 macro-regions: Western Europe, which includes 6 microregions, Northern Europe (10 microregions), Southern Europe (13 microregions), Eastern Europe (9 microregions), Western Asia (13), Central Asia (1), Southern Asia (5), Eastern Asia (5), South-eastern Asia (6), Africa (5), Northern America (2), Central America (3), Caribbean (2), South America (8), Russian Federation. The integral index is used to calculate the evaluation indicators of each macro-region, which is defined as the arithmetic mean of indices of private indices (micro-regions)

$$I = \frac{\sum_{i=1}^n I_i}{n}$$

I- integral index; n- number of micro-regions,  $I_i$  –value of the i-th private indicator. The factors that characterize different areas of human life influencing the satisfaction of his needs and comfortable living in the territory were selected as private criteria and indicators. The components included in the method of assessment of welfare and quality of life of the macro-regions inserted into the table.

*Table following on the next page*

*Table 1: Criteria used to assess the well-being and quality of life of the regions  
 (Own elaboration)*

	Private evaluation criteria	Indicator characterizing the criterion
	<b>Economic infrastructure</b>	
1	Household final consumption expenditure	Average monthly expenses of households per capita, dollars
2	Unemployment	Unemployment rate, % of total labor force
3	Net migration rate	migrant(s)/1,000 population.
4	Transport infrastructure	Quality of transport related infrastructure (e.g. ports, railroad, roads).
	<b>Social infrastructure</b>	
5	Education	Proportion of children at the early grades of primary education achieving at least a minimum proficiency
6	Utilities	Prices by Country of Basic (Electricity, Heating, Cooling, Water, Garbage) for 85m2 Apartment (Monthly), dollars
7	Rental Housing	Price Rankings by Country of Apartment (3 bedrooms) Outside of Centre (Rent Per Month), ), dollars
8	Health Care	An estimation of the overall quality of the health care system, health care professionals, equipment, staff, doctors, cost, etc.
9	Safety	Estimates of the total level of crime in the macro-region.
10	Life expectancy	Average life expectancy of the population, total (years)
	<b>Ecological infrastructure</b>	
11	The natural environment	An estimation of the overall pollution in the region
12	Recycling	The share of recycled waste from all existing, %

It is obvious that the components used to assess well-being have different dimensionality. We have conducted a ranking of traits to be able to compare and identify the most significant components for the region

### 3. THE RESULTS

The well-being of citizens is depending on the harmony development of all spheres of life to the greatest extent Unevenness and imbalances in development are particularly noticeable in the global economy in comparison with other regions. The calculated data for the selected criteria are represented in the radar chart; with its help, we can identify priority areas for achieving harmonious development for each macro-region; carry out a comparative analysis of the macro-regions, which have multidirectional vectors of development. Eastern Asia has a high rank in many indicators, for example, life expectancy averages at 78.8 years and ranks 4th place among all macro-regions, has the lowest level of crime. The macro-region recycling of 51.2 % of waste on its territory. It has the best indicators of education 99.6% of children are enrolled in primary school, unemployment is 3.5%. However, it lags behind in terms of housing and domestic conveniences: rent per month for the apartment (3 bedrooms) is \$1173.04 and monthly payment of utility services for 85m2 apartment cost \$122.27. For this reason, utilities and rental housing are the priority set of criteria in the macro-region.



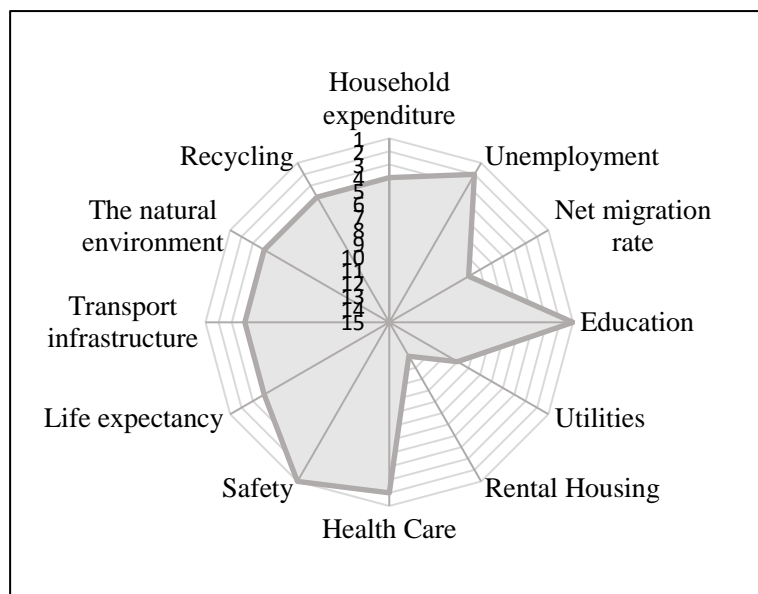


Chart 1: Eastern Asia (Own elaboration)

Southern Europe has a tilt angle in the direction of economic and ecological development. Monthly household expenditures are \$614.25 per capita, therefore the macro-region takes the 7th place in the ranking, transport infrastructure is well developed, life expectancy is 78.77 years. However, the macro-region has high level of unemployment at 14.1% in economic infrastructure. There are weaknesses in the social infrastructure, despite the relatively cheap rent (\$564.9), utility costs are rather expensive (\$141.25 per month). The priority set for harmonious development is the reduction of the unemployment rate and the prices of utilities.

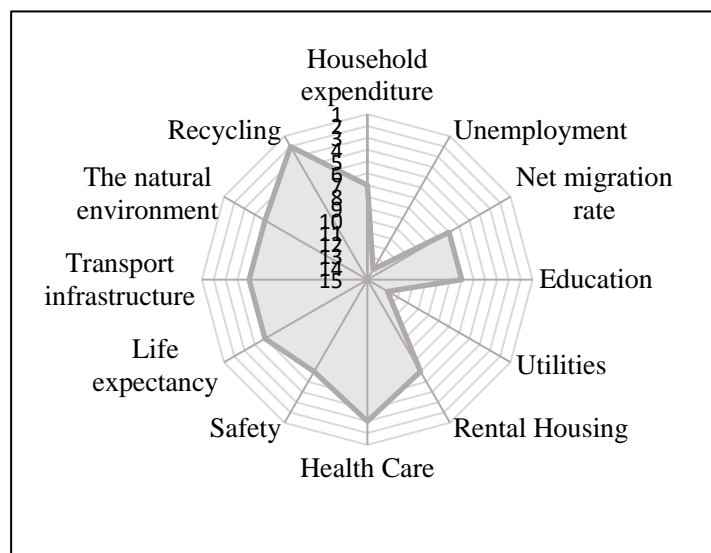


Chart 2: Southern Europe (Own elaboration)

Southern Asia is macro-region with special development situations. The macro-region brings together some poor countries, and its analysis is significant with a view to the identification of meaningful patterns. There is no development in the environmental infrastructure; in the economic infrastructure, the only difference is unemployment, which is 5.9%; in social infrastructure can be identified the cheapest rent of habitation (\$309.9) and the lowest prices for utility services (\$40.44).

Identified such a trend that in developed regions have housing rent and utilities are more expensive than less developed regions.

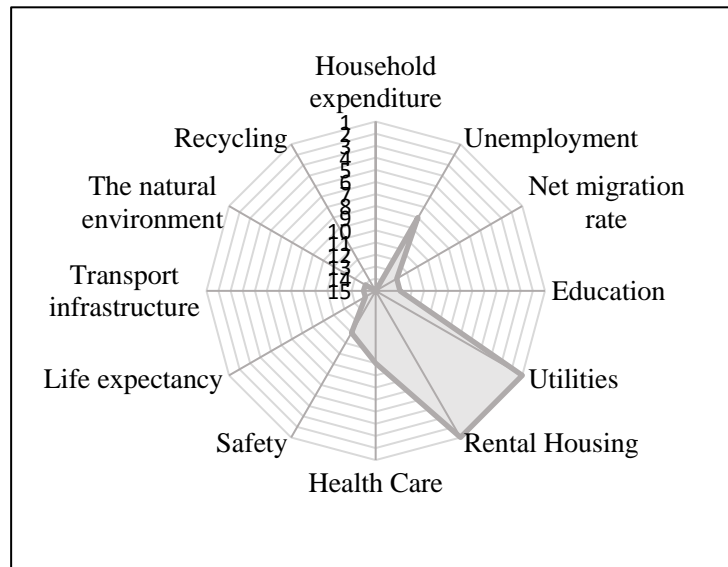


Chart 3: Southern Asia (Own elaboration)

In the Russian Federation, the vector of development is directed towards the socio-economic infrastructure. The unemployment rate is 5.3% (4th place in the rating), there are 1.7 migrants per 1000 citizens, 98.3% of children received primary education. However, the social infrastructure is not in full, health care is not developed, life expectancy is the lowest among the regions is 71 years. Ecological infrastructure is not developed because of regional-characteristics: mechanisms for recycling of wastes is not (cheaper to throw away than to recycle); the environment is in the last place in the ratings of macro regions due to numerous industrial enterprises. In terms of economic infrastructure, per capita expenditure is \$381.18 per month and ranked 12th in the rating. The priority direction in the Russian Federation is to develop of ecological infrastructure

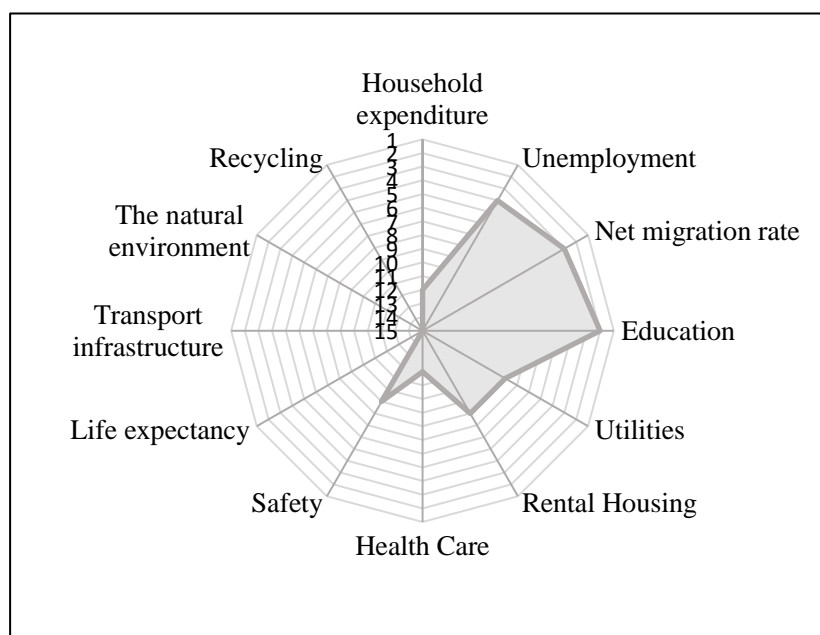


Chart 4: Russian Federation (Own elaboration)

Based on the analysis of 15 regions, we have identified the most harmoniously developed region, i.e. a region which has no pronounced direction of development. Eastern Europe is developing evenly in all directions. Household expenditure per capita is \$439.82. Unemployment is 5.28%/ In terms of education ranked 7th in the ranking. Rental Housing is \$510. All criteria are of average value.

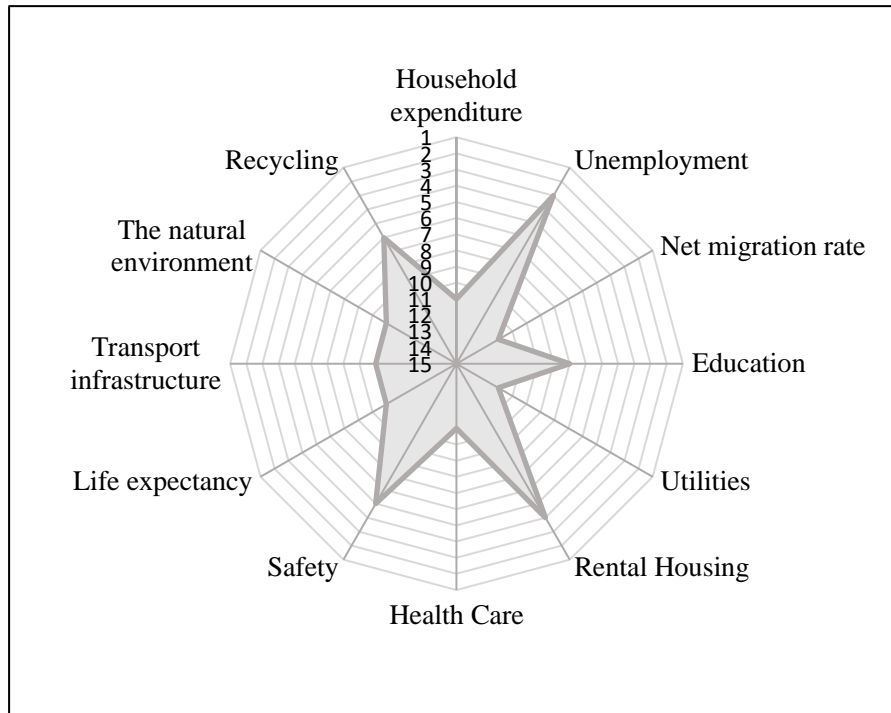


Chart 5: Eastern Europe (Own elaboration)

#### 4. CONSLUSION

Considering the conducted theoretical researches is possible to assert that the research of a regional aspect is important in the estimation of well-being and quality of life. Using the concept of converged regions, the allocation of macro and microregions is justified. The study of well-being is based not only on the set of benefits used but also on the assessment of comfort. The narrowness of the use of quantitative criteria is the basis of a rating methodology that characterizes the conditions and degree of satisfaction. The infrastructure blocks that form the conditions of well-being are allocated. The calculation of the integral index allows estimating the comfort of living in the territories. The main aspect of the assessment of the level of well-being and quality of life determined by the uneven development.

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## MONEY LAUNDERING IN INTERNATIONAL COMMERCIAL ARBITRATION

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### **ABSTRACT**

*International commercial arbitration is currently the preferred method of resolution of disputes originating from international business transactions. It is not only the number, but also the diversity and complexity of disputes that have been growing. At present, arbitrators also deal with criminal offences that may have serious impact on society and economy, e.g. corruption, fraud and last but not least money laundering. It is not disputed that decisions on criminal sanctions remain exclusively in the hands of national courts. However, this does not mean that the arbitrators are precluded from applying criminal laws. The occurrence of money laundering within the international commercial arbitration is a complex issue raising a lot of questions, e.g. arbitrability of such disputes, validity of arbitration agreement, applicable criminal law, evidence, duties of arbitrators, review of arbitral awards etc. As it is not possible to deal with all these question this paper focuses only on several aspects. Two possible situations in which money laundering can manifest in international commercial arbitration are identified. First, money laundering can be alleged by a party as defence to the enforcement of a contract in dispute. Second, arbitration can be abused for laundering of illicit assets. The paper further deals with the arbitrators' legal obligations under criminal and regulatory law in the face of suspected or alleged money laundering. In this part the paper focuses especially on the second scenario, e.g. when arbitration is abused for money laundering. The paper analyses if the arbitrators are covered by criminal law provision on money laundering and on notification duties. The paper also analyses if the arbitrators fall within the scope of regulatory system imposing identification and reporting duties. In this part the paper reflects especially relevant provisions of Czech and EU law.*

**Keywords:** *international commercial arbitration, money laundering, criminal laws, arbitrator, criminal liability, intention, negligence, investigation, notification, witness, EU directive*

### **1. INTRODUCTION**

International commercial arbitration is currently the preferred method of resolution of disputes originating from international business transactions, and it represents a full-fledged alternative to dispute resolution before national courts. With the growing volume of international trade, the international commercial arbitration has become an increasingly utilized instrument. It is not only the number, but also the diversity and complexity of disputes that have been growing. At present, arbitrators may also face disputes affected by criminal conduct that may have serious impact on society and economy, e.g. corruption, fraud or money laundering. It is not disputed that decisions on criminal sanctions remain exclusively in the hands of national courts. However, this does not mean that arbitrators are precluded from deciding such disputes and applying criminal laws. The occurrence of money laundering within the international commercial arbitration is a complex issue raising a lot of questions, e.g. arbitrability of such disputes, validity of arbitration agreement, applicable criminal law, evidence, duties of arbitrators, review of arbitral awards etc. As it is not possible to deal with all these question this paper focuses only on some of them. First, the aim of this paper is to identify two possible situations in which money laundering can manifest in international commercial arbitration. Secondly, the paper analyses possible criminal liability of arbitrators in the case that arbitration is abused for money laundering. In this part, the liability is analysed under Czech criminal law.

Thirdly, notification or reporting duties of arbitrators are dealt with. In this part the paper reflects especially relevant provision of Czech criminal law and EU law.

## **2. INTERNATIONAL COMMERCIAL ARBITRATION AND CRIMINAL LAW – GENERAL REMARKS**

The relationship between criminal law and arbitration mainly concerns, but is not limited to, economic crimes (e.g. corruption, money laundering, fiscal crimes, falsification of documents, violation of foreign trade regulations etc.). In principle, it is possible to distinguish two situations. First, arbitrators face disputes affected by the criminal conduct that has arisen outside arbitration, usually prior to the commencement of arbitration. Secondly, a crime occurs during the arbitration itself and is committed either by parties (e.g. falsification of a document or another evidence, false statement, embezzlement of an arbitrator, money laundering) or by arbitrators (e.g. fraud, bribery taking, money laundering). The former situation is more probable and is more often discussed. In the area of international commercial arbitration, the issue of corruption is most often debated. Allegations of criminal conduct in international commercial arbitration are not a new issue (Betz, 2017, p. 3). The landmark ICC case No. 1110 dates back to 1963. The literature dealing with this topic regularly cited the conclusions of the well-known Swedish arbitrator Lagergren. The plaintiff was an important Argentinian businessman; the defendant was a British company operating on the Argentinian market. The defendant had been interested in supplying electrical equipment to the Buenos Aires region. It asked the plaintiff, who was an influential person in the politics and business, to support its offer. The parties entered into an agreement, under which the plaintiff was to obtain a certain percentage from contracts concluded by the defendant with Argentinian authorities as a commission. In the end, the defendant only concluded one contract, and refused to pay the commission to the plaintiff. Subsequently, the parties entered into an arbitration agreement and referred the dispute to a sole arbitrator in accordance with then valid ICC Rules. The venue of arbitration was France. The arbitrator, on his own motion, decided to review his jurisdiction and looked into the issue of arbitrability from the viewpoint of the French as well as Argentinian law. He concluded that he had no jurisdiction in the matter, because the case involved gross violation of good morals and international public policy and could not be tolerated by any court or arbitral tribunal in a civilized country (van den Berg, 1996, pp. 47–53). It is possible to derive from the above award that a dispute affected by corrupt practices of the parties is not arbitrable. The literature also mostly derives this conclusion (Blackaby et al., 2015, p. 120, Born, 2014, p. 990, Lew, Mistelis, Kröll, 2003, p. 215). However, we can at least raise doubt whether this conclusion really ensues from the award. Certain parts of the award suggest that the award does not in fact deal with arbitrability, but with the admissibility of the claim (Mourre, 2009, p. 211). This corresponds to the contemporary trend. Disputes affected by a criminal conduct are arbitrable (Blackaby et al., 2015, p. 119, Banaiftemi, 2015, p. 16, Neuber, 2015, p. 4, Ziadé, 2015, p. 119, Born, 2014, p. 990). Arbitrators are in such cases entitled to decide on the merits of the dispute. In other words, they have the jurisdiction to decide on the private-law sanction of such practices. More often than with arbitrability, this issue is connected with the validity of the arbitration agreement. The main contract affected by criminal offence is usually invalid. However, due to the principle of separability, this shall not automatically affect the validity of the arbitration agreement unless it is invalid for the same reason. Thus, arbitrators may have jurisdiction to decide on the matter itself, i.e. on the validity of the main contract (Neuber, 2015, p. 5). In connection with criminal conducts, the contemporary theory and the practice do not deal with the issue of arbitrability or validity of the arbitration agreement, but rather with issues concerning the resolution of the disputes before arbitrators, in particular under which law to assess criminal conduct, arbitrator's duty to ascertain criminal conducts on their own motion, burden of proof or notification duties of arbitrators (Neuber, 2015, p. 3).

### **3. MANIFESTATION OF MONEY LAUNDERING IN INTERNATIONAL COMMERCIAL ARBITRATION**

There are two possible scenarios how the money laundering can arise within the context of international commercial arbitration. First, one of the parties to arbitration alleges that the other party was involved in a money laundering and uses this as a defence to the enforcement of the contract in dispute (Betz, 2017, p. 49). Betz provides in her book *ad hoc* arbitration case in which this scenario occurred (Betz, 2017, pp. 236–247). Secondly, the arbitration proceedings can be abused for the laundering of illicit assets. In such a case the arbitration proceedings are sham, there is no real dispute between the parties, but both parties wish to have certain issues legally decided in order to deceive third persons or authorities (Bělohlávek, 2008, p. 680). We can distinguish two scenarios here. First, the parties handle the fair arbitrator in order to render the award which legalise their criminal activity. Secondly, also arbitrators or most of them are part of this abuse. How can the arbitration proceedings be abused? For example, offender(s) of a “main crime” (e.g. production or sale of drugs) establish two separate companies which at first sight do not have anything in common. These companies conclude the contract including the arbitration clause. Under such contract one company may be obliged to sell to the other products or to provide services. The contract may be sham or may contain excessive prices. One of the companies later on commences arbitration proceedings and claim the fulfilment of the obligation or damages. The arbitrators order the respondent to pay. The respondent pay by illicit assets. The claimant thus receives money based on the enforceable award. The assets having their origin in criminal activity are legalised (Bělohlávek, 2008, p. 929). Betz provides for another example. An European real estate seller commences arbitration proceedings and raises a claim arising out of a fake dispute. It claims inflated or non-existent purchase price from a complicit buyer located in a country known for its problems with drug production. Arbitrators render the award in favour of claimant. Based on the award a sum of money is transferred to seller’s account without being questioned by the bank and the money launderer acquires valuable real estate that can be further sold (Betz, 2017, pp. 49–50). During the proceedings, the parties have to pretend in order to persuade the tribunal to confirm the claim against the respondent. In order to be sure that the claimant “will win the case” the respondent for example could have a weak defence, non-credible witnesses etc. (Bělohlávek, 2008, p. 680, Blackaby et al., 2015, p. 332). The respondent may also recognise the claim or the parties can settle during arbitration and ask the tribunal to issue the “consent” award (Betz, 2017, p. 50, Blackaby et al., 2015, p. 332). The arbitration proceedings are more easily abuse able than the court proceedings. Arbitration in this regard has several “advantages” – it is private, arbitrators and usually also the parties are bound by the duty to maintain confidentiality, the parties can choose the seat and venue of arbitration, they can choose arbitrators and last but not least, the award is enforceable (Bělohlávek, 2008, p. 946). In the following part the paper will focus on the possible criminal liability and legal obligations of arbitrators in the case the arbitration is abused for money laundering.

### **4. ARBITRATORS’ LEGAL OBLIGATIONS**

#### **4.1. Criminal liability of arbitrators**

Taking into account that the arbitration can be abused for money laundering, may an arbitrator also commit a crime or be a complicit in money laundering? Even if there are various opinions as to the arbitrators’ immunity, it is not disputed that arbitrators are not immune from criminal liability (Moses, 2017, p. 163). The answer as to the criminal liability has to be found in the applicable criminal law. Based on the principle of territoriality, in most cases it will be the criminal law of the state in which the seat of arbitration is located. When considering the liability of an arbitrator the relevant action will most probably be rendering of an award. In international commercial arbitration, an award is rendered in the state where the seat of

arbitration is located. As was stated in the introduction, this part focuses on the regulation under Czech law. Under Section 4 of the Czech Criminal Code (Act No. 40/2009 Coll., Criminal Code) an action is judged under Czech criminal laws if it was committed in the territory of the Czech Republic. The actions of an arbitrator can be assessed under the Czech Criminal Code particularly if the arbitration is seated in the Czech Republic. Money laundering is covered by Czech Criminal Code in two provisions – Section 216 and Section 217. Both of them reflect the international and EU commitments of the Czech Republic. Section 216 covers two bodies of crime. Under the first one, a person commits a crime if he conceals the origin or otherwise aims to substantially aggravate or make impossible to find out the origin of a thing or other property values which were acquired by a crime committed either in the territory of the Czech Republic or abroad, or as a reward for such crime. The same applies to a thing or other property values that were obtained for the thing or other property values mentioned in the previous sentence. To conceal the origin means in particular money laundering in strict sense. However, the notion is wider as it relates not only to money, but also to other things and property values. To conceal means that the information about the origin is kept in secret or angled. The means of concealment include in particular the transfer of property, investment of money into the legal business, keeping in secret the real nature of a thing, the disposals of a thing etc. The notion “aim to substantially aggravate or make impossible” covers any other action which directs to the result that the proceeds from the criminal activity can be used by the offender or by other persons without any problem. It covers mainly the preparation phases to concealment. The offender can be any natural or legal person including the offender of the main crime (the crime from which the thing or property value comes). The intention of the offender is required while *dolus eventualis* is sufficient (Šámal et al., 2012, pp. 2154–2158). Section 216 contains the second body of crime under which a person commits a crime if he enables another person to commit the above mentioned crime. It is a qualified kind of help which in itself represents a crime. The help can be of any nature. The intention is required here as well (*dolus eventualis* is sufficient). Therefore, the offender of this crime has to act with the awareness that the person who is enabled to commit the crime acts with the intention to conceal the origin (Šámal et al., 2012, p. 2157). Taking all this into account within the context of abuse of international commercial arbitration we have to distinguish whether the parties abuse fair arbitrator or whether an arbitrator “cooperates” with the parties. In the latter case an arbitrator can be liable under Section 216. For example by issuing the award incorporating the settlement between the parties the arbitrator enables another person (other persons) to conceal the origin of the property. On the other hand, in the former case, we can suppose that the arbitrator is not aware of the intention of the parties. The arbitrator is not aware the parties use the arbitration in order to conceal the origin of money. Therefore, the intention of the arbitrator is not present. For our purposes, Section 217 of the Czech Criminal Code can be more important. A person commits the crime under this provision if he enables to conceal or to find out the origin of a thing or other property values which were acquired by a crime committed either in the territory of the Czech Republic or abroad, or as a reward for such crime. The thing or value must have “higher value” which means at least 50 000 CZK (see Section 138 of the Czech Criminal Code). What is the most important, the negligence of the offender is enough here. The unconscious negligence is sufficient (Šámal et al., 2012, pp. 2163–2165). “Unconscious negligence” means that the offender did not know that he could by his action violate or threaten the interest protected by the Criminal Code, however, he ought to have known and could have known taking into account all circumstances and personal relations of the offender (Section 16 of the Czech Criminal Code). An arbitrator has primarily the responsibility to the parties. His main obligation is to decide a private dispute between the parties. He relies on the facts provided by the parties and he is bound by the claims that were raised by the parties. Otherwise he risks decision “*ultra petita*” which can lead to the annulment of the award or to the refusal of the recognition of an



award. Does this mean that the arbitrator has to stay passive? Or is he allowed/obliged to employ any investigation? The more so, if there is risk of his own criminal liability. It is now assumed in the practice of international commercial arbitration that with the increasing area of arbitrable disputes the arbitrators are expected to do more than just resolve a private dispute between the parties (Moses, 2017, p. 90). If the parties abuse the arbitration proceedings it is clear that none of them will raise the issue of money laundering in the proceedings. The question is whether an arbitrator has to deal with the possible existence of criminal conduct on his own motion. It can be concluded that the arbitrator is not an investigator or public prosecutor. Therefore, he is not obliged to identify any possible violations of criminal law that may have occurred. However, there may be situations where the information submitted by the parties or other unusual circumstances indicate that money laundering may take place. In such a case the initiative of the arbitrator is proper. Not only arbitrator's criminal liability may be at stake, but also the public interest is touched. If it were found that arbitration is being used as a tool to circumvent criminal law, its reputation could be seriously undermined (Bělohávek, 2008, p. 874). Should arbitration become a safe harbour for illegality, it would be rejected not only by states but also by the business community itself (Mourre, 2009, p. 236). Even the practice of arbitration suggests that the arbitrators can and should deal with criminal offenses on their own initiative (Ziadé, 2015, p. 120). What shall the arbitrator do if he suspects that the proceedings are abused? First, he can resign (Betz, 2017, p. 51). Secondly, he can make further investigations on his own motion. The arbitrator of course cannot decide on the criminal liability of the parties. This is fully in the hands of national courts. The arbitrator can only assess if the actions of the parties possibly constitute a crime and draws consequences for the arbitration proceedings. In the case of money laundering arbitrators should terminate the proceedings on the basis that there is no genuine dispute (Blackaby et al., 2015, p. 333). They can also come to the conclusion that the arbitration agreement is invalid as the real intention of parties to arbitrate is missing. The arbitrator's duty to investigate has in principle two main limits. First, it is the right of the parties to a fair trial. If an arbitrator suspects money laundering and decides to further “investigate” it must give the parties a reasonable opportunity to comment. Secondly, the arbitrator must confine himself to investigate only such conduct that is directly relevant to the parties' claims in arbitration. The arbitrator should only proceed with the investigation if there is *prima facie* evidence of the existence of criminal behaviour (Neuber, 2015, p. 5; Ziadé, 2015, p. 121). There are “red flags” which can indicate that the arbitration proceedings may be abused, e.g. companies involved have been recently incorporated, their activities do not require any real investment or the contract in question is not very detailed or well drafted (Blackaby et al., 2015, p. 332). Even if the parties settle and ask the arbitrator to render consent award, the arbitrator is not without power. Under national laws or rules of arbitrations institutions, he is usually not obliged to issue such award automatically (Bělohávek, 2008, p. 930). For example Article 33 of 2017 ICC Rules requires the consent of the tribunal. Arbitrators should be very cautious in agreeing to an early consent award which only involves the payment of money (Blackaby et al., 2015, p. 332). Going back to Article 217 of the Czech Criminal Code, in the author's opinion there is at least theoretical possibility that an arbitrator may be liable. This would be in the case if he had *prima facie* evidence that the money laundering could be at stake, however he did not make any further investigation and decided in favour of claimant, or without any investigation rendered an award based on the settlement of the parties.

#### **4.2 Reporting duties**

When an arbitrator becomes aware of money laundering during arbitration, does he has any duty to report public authorities? The key element here is privacy of arbitration and arbitrators' duty to maintain confidentiality.

The privacy of international commercial arbitration is internationally respected (Crookenden, 2009, p. 603). It is also generally accepted that an arbitrator is bound by the duty to maintain confidentiality (Lew, Mistelis, Kröll, 2003, p. 283, Born, 2014, p. 2004). This existence of this duty results from the very nature of arbitrators' function. It would be incompatible with the mandate of an arbitrator to divulge information about arbitration to third parties (Smeureanu, 2011, p. 142). The duty to maintain confidentiality is the key part of arbitrator's role (Born, 2014, p. 2004). The arbitrators' duty regularly results also from other sources. For example, it can be expressly provided in national arbitration law. This is the case of the Czech Republic. Section 6(1) of Czech Arbitration Act (Act. No. 216/1994 Coll., on arbitration and on enforcement of arbitral awards) obliges arbitrators to maintain confidentiality. The scope of arbitrators' duty is wide, this does not, however mean that no exceptions exist. The exceptions can *inter alia* result from the criminal law provisions. For example, criminal laws can provide for notification duties regarding the criminal conduct of other persons. The violation of such a duty can in some cases constitute a crime. Section 386 of the Czech Criminal Code provides that a person commits a crime if he has learned by a credible way that another person has committed one of the crimes named in this provision and does not notify this to the police or public prosecutor. However, money laundering is not mentioned in this provision. Thus, an arbitrator cannot commit a crime by not notifying the authorities about money laundering of which he has become aware during arbitration. Criminal procedure laws usually provide for various obligations of natural and legal persons concerning the cooperation with public authorities including the obligation to witness. Are arbitrators also bound by these obligations? Section 8(1) of the Czech Code of Criminal Procedure (Act No. 141/1961 Coll., Code of Criminal Procedure) states that natural persons are obliged to comply with requests of authorities active in criminal proceedings while these authorities fulfil their obligations. However, Section 8(4) states that a natural person can refuse fulfilling the obligation under para. 1 if he has a duty to maintain confidentiality recognised or imposed by the state. Duty to maintain confidentiality recognised or imposed by state means the duty imposed or recognised by another legal act (Section 124 of the Czech Criminal Code). As Section 6(1) of the Czech Arbitration Act expressly provides for the arbitrators' duty to maintain confidentiality, it is a duty recognised or imposed by state (see also Šámal et al., 2012, p. 1339). The refusal under Section 8(4) is not possible if the person risks the liability under Section 386 of the Czech Criminal Code. As was previously stated this is not the case of money laundering. Section 8(4) of the Czech Code of Criminal Procedure does not mean that the arbitrator's duty to maintain confidentiality cannot be broken. Under Section 6(2) of the Czech Arbitration Act an arbitrator can be exempted from his duty. First, the parties themselves can agree on such an exemption. In the case of criminal conduct of the parties this is not probable. Second, the president of a district court can exempt the arbitrator for serious reasons. The serious reasons are not defined in Section 6. In the author's opinion serious reasons cover also the situation when the information originating in arbitration shall be used in criminal proceedings. The authorities active in criminal proceedings are allowed to ask for the exemption (Bělohávek, 2008, p. 694). Under Section 97 of the Czech Code of Criminal Procedure everybody is obliged to come upon summons and witness what he knows about a crime, an offender or circumstances important for criminal proceedings. Section 99(2) then states that a witness cannot be heard if the testimony breaches the duty to maintain confidentiality recognised or imposed by the state, unless the witness is exempted from his duty by a competent authority. Thus, an arbitrator is obliged to come upon summons. However, he cannot be heard unless the parties or the president of a district court exempt him from his duty to maintain confidentiality. Section 99(2) does not apply if the witness has the obligation to notify a crime under Section 386 of the Criminal Code. Concerning the money laundering another question is discussed in the literature (see e.g. Blackaby et al., 2015, p. 333, Betz, 2017, p. 51–52) – whether an arbitrator is an obliged entity

in the sense of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing which repeals Directive 2005/60/EC. There are discussion whether an arbitrator can be regraded as an independent legal professional in the sense of Article 2(1)(3). In the author's opinion an arbitrator does not fall within this category (see also Blackaby et al., 2015, p. 333). It would be, however, useful for an arbitrator to see how the directive has been implemented in the Member States. In the Czech Republic the Directive is implemented by the Act No. 253/2008 Coll., on certain measures against money laundering and terrorist financing. Even under the Czech act an arbitrator cannot be subsumed under any category of obliged entities.

## 5. CONCLUSION

Even though international commercial arbitration is primarily the way how to solve private commercial disputes, arbitrators may at present also face disputes affected by criminal offences including money laundering. The occurrence of money laundering within the international commercial arbitration is a complex issue raising a lot of questions. This paper focused only on few of them. First, few general remarks on the relationship between criminal law and international commercial arbitration were made. Arbitrators of course do not have power to decide on criminal sanctions. However, this does not mean that a private dispute affected by criminal conduct is not arbitrable. Arbitrators have the jurisdiction to decide on the private-law consequences. Moreover, even if the main contract affected by criminal practices may be invalid, this shall not automatically affect the validity of the arbitration agreement unless it is invalid for the same reason. In connection with criminal conducts, the contemporary theory and the practice do not deal with the issue of arbitrability or validity of the arbitration agreement, but rather with issues concerning the resolution of the disputes before arbitrators, in particular under which law to assess criminal conduct, arbitrator's duty to ascertain criminal conducts on their own motion, burden of proof or notification duties of arbitrators. The paper further identified two possible scenarios how the money laundering could arise within the context of international commercial arbitration. First, one of the parties to arbitration alleges that the other party was involved in a money laundering and uses this as a defence to the enforcement of the contract in dispute. Secondly, the arbitration proceedings can be abused for the laundering of illicit assets. In the context of the second situation the paper then dealt with the possible criminal liability of arbitrators. It is not disputed that arbitrators are not immune from criminal liability. The liability of arbitrators was assessed under Czech criminal law. Section 216 of the Czech Criminal Code covers intentional money laundering. It is thus necessary to distinguish whether the parties abuse fair arbitrator or whether an arbitrator “cooperates” with the parties. Only in the latter case an arbitrator can be liable under Section 216. Section 217 covers negligent money laundering. For the purpose of this provision it was necessary to analyse whether an arbitrator had a duty to further investigate in the case where the information submitted by the parties or other unusual circumstances indicated that money laundering might take place. We came to the conclusion that the initiative of the arbitrator was proper and necessary. When the arbitrator suspects that the proceedings are abused, he should further investigate and draw consequences for the arbitration proceedings. In the case of money laundering arbitrators should terminate the proceedings on the basis that there is no genuine dispute. Even if the parties settle and ask the arbitrator to render consent award, the arbitrator is not without power. Arbitrators should be especially cautious in agreeing to an early consent award which only involves the payment of money. The author came to the conclusion that there was at least theoretical possibility that an arbitrator might be liable under Section 217. The final part of the paper analysed the reporting duties. The existence of such duties depends on the national criminal law or other regulatory framework. Generally, it can be said the arbitrator's duty to maintain confidentiality plays a key

role in the existence and scope of reporting duties. The author admits that she has not found any available case concerning the abuse of arbitration proceedings (see also Betz, 2017). This does not, however, mean that such situation may not happen. The most probable reason why no case is available is the privacy and confidentiality of arbitration. It is also possible that such cases are rare in the practice as there are other, more traditional, ways of money laundering (Bělohlávek, 2008, p. 945).

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## PASSENGER (CONSUMER) LEGAL POSITION IN PACKAGE TRAVEL REGULATIONS

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### **ABSTRACT**

*There have been great changes in the market of travel services with regard to growing use of new technologies and digital online platform for the sale and reservation of travel, which resulted in the provisions on the protection of the passengers as consumers no longer corresponding to modern conditions in the market of services of the travel. This paper presents the author's reflections on passenger (consumer) legal position in new package travel regulations, according to the Croatian newly enacted Act on the providing of Services in Tourism, which came into force on January the 1<sup>st</sup> 2018, incorporating into national legal framework Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market and the (EU) Directive 2015/2302 of the European Parliament and of the Council of 25 November, 2015 on package travel and linked travel arrangements. One of the most important novelties represents the extended area of the protection of passengers (consumers) in traditional package travel. The new regulation, in author's opinion, reinforces and clarifies passengers (consumers) rights, but there are also cases of lowering of consumers rights.*

**Keywords:** *Act on the providing of Services in Tourism, consumer, Directive 2015/2032, Package travel, Tourism Law*

### **1. INTRODUCTION**

There have been great changes in the market of travel services with regard to growing use of new technologies and digital online platform for the sale and reservation of travel, which resulted in the provisions on the protection of the passengers as consumers no longer corresponding to modern conditions in the market of services of the travel. Council Directive 90/314/EEC of June 1990 on package travel, package holidays and package tours, (OJ L 158, 23. 6. 1990) (hereinafter: Directive 90/314/EEC), determined a series of consumer rights in relation to travel in package travel and it was one of the first documents and legal instruments to improve consumer protection in EU (Leeuwen van, 2017, p.7) However, since its adoption market travel services has significantly changed..(Barun, 2016, p.309). With the increasing number of Internet users - 65 % of EU citizens used Internet once a week (Eurostat, Data in Focus, 50/2010), travel services are more likely to provide on the Internet. In 2011, the sale of travel services on the Internet accounted for approximately 35% of all travel booking. Only in March 2013, almost 183 million people visited the web site for travel services (Market travel services on the Internet). Although today the 23% of passengers from the EU still buys traditional pre-defined packages, more travelers paid various parts of the trip separately. (54% of Europeans who went on holiday in 2011.) or pay in the customized vacations that combine one or more trade related traders according to the needs and taste of the passengers. Although it is typical for sale on the Internet, that kind of format offer branch offices of travel agencies that combine vacations for their customers (Communication from the Commission to the European Parliament, the Council, the European economic and Social Committee and the Committee of the regions on the introduction of the EU's oravila about travel in package travel in the digital age, Brussels, 9.7.2013.COM (2013) 513 final). The new rules include two types of contract, package arrangements (agreed in advance by a travel agency or customized by the

passenger) and a new way of travel reservation which is called associated travel arrangement, and where users are guided to, for example, after have booked their flight, to book additional travel services through targeted online links. Travel and vacations in the package travel are a complex combination of travel services, which usually include the services of transport and accommodation, and may include other services such as the car rental services and organized excursions. Since various service providers are usually included, if there's a problem with one service, it can affect the other. Contacts with subcontractors can be difficult for the passengers because of language barriers or cultural differences at the destination of travel, and in these cases, passengers would not have concluded the contract with various service providers. Croatian newly enacted Act on the providing of Services in Tourism, which came into force on January the 1<sup>st</sup> 2018, except for the articles concerning package travel and linked travel arrangements whose application has been postponed until 1.7.2018., incorporating into national legal framework Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market and the (EU) Directive 2015/2302 of the European Parliament and of the Council of 25 November, 2015 on package travel and linked travel arrangements. One of the most important novelties represents the extended area of the protection of passengers (consumers) in traditional package travel. The new regulation, reinforces and clarifies passengers (consumers) rights, but there are also cases of lowering of consumers rights.

## **2. PACKAGE TRAVEL AND LINKED TRAVEL ARRANGEMENT IN CROATIAN LEGAL ORDER**

The package arrangement contract is a named contract which is governed by the provisions of more legal texts, under different names, within the Croatian legal order. Obligations Act (hereinafter: ZOO) regulates it in the theory and practice under a longlived name - the contract for the provision of travel facilities, while the law on the provision of services in the tourism industry from 2007.(hereinafter: ZPUT 07) calls it a package arrangement, and as a synonym the lump-sum travel. It's the so-called status law, which is until the enactment of a new law on the provision of services in the tourism industry from 2017. regulated the conditions and manner of provision of services in the tourism industry (Petrić, 2013., str.63.), so it's provision had significance in regulating relations in relation to the contract of a package arrangement, or the provision of travel facilities, as ZOO calls it. A relevant source of law for the contract of the package arrangement is the law on consumer protection (hereinafter: ZZP) which uses the concept of consumers, by defining it as a natural person who enters into legal work or works on the market outside of your trade, business, craft or professional activities (Article 5, point 15. ZZP) The narrower definition of the term consumer has been accepted in the majority of consumer directives such as Brussels Convention on the jurisdiction of the courts in civil and commercial disputes( OJ L 304/3678) and Rome Convention on the applicable law for contractual relations ( OJ L 266/1/80), as well as in the judicial practice of the European Court of Justice (case C-150/77 of June 21, 1978, Societe Bertrand v.Paul Ott.KG (1978) ECR 01431), but such a such a narrower term is not always appropriate. Part of the theory of the European consumer rights pointed out that it would be much more acceptable to use term consumer under objective criteria, i.e..according to the nature of the relationship of the parties in the contract.(Alpa, 1999, p. 1178.sq.) If a concrete agreement on organizing travel falls in the category of consumer contracts, according to the provisions of the ZZP, the provisions of ZOO are applicable as well (Petrić, 2013, p.63). Directive (EU) 2015/2302 in the Article 3. paragraph 6. provides a clear definition of the term passenger as a person who concludes a contract or is authorized to travel on the basis of a contract that falls within the application of this Directive, including the passengers who travel for business reasons, provided they do not travel on the basis of a framework contract with a dealer specialized for organizing business

travels. Directive 90/314 in the Article 2. paragraph 4. deviated from such a narrow concept, and the consumer was defined as a person who takes or agrees to take tourist package arrangement (main contractor) or the person on whose behalf the main contractor agrees to take the package arrangement (other users) or any other person to whom the main contractor or any another user transfers a package arrangement (receiver). (Nebbia and Askham, 2004, p. 36-41, Petrić, 2014, p. 250-251). The existing terminology non-conformities, although present in the business practices of companies in the tourism industry, represent a disadvantage that should be removed as soon as possible. Also, solutions of the ZOO and ZPUT, are not always consistent, which could create serious problems in future touristic practice.

### **2.1. Contract for the provision of travel facilities in the Obligations Act 2005.**

The rights and obligations of both parties to a contract for the provision of travel facilities, and, in particular, the obligation of compensation of damage are regulated in detail by the provisions of articles 881-908. ZOO 05. Article 881. paragraph 1 defines it through the obligation of the travel organizer to the passenger get a set of services that consist of transport, accommodation or other tourist services, while on the other side, there is an obligation of the passenger to pay for that total (lump) price. The content and format of the contract is determined by the article 884. ZOO. The organizer can't enter into the agreement provisions that restrict or have turned off their liability for damage. Such provisions would be invalid. The organizer is liable for all damage resulting unfulfilling, partial or undue fulfilling of their obligation. Equally the organizer is liable for damage caused by a third person whom he entrusted the execution of the services of transport, accommodation or other services (article 889 ZOO). If an incomplete or untidy of execution of services under the contract occur, the passenger has the right to a proportionate reduction in prices if a complaint is invested within eight days from the end of the journey (article 890 ZOO). Obligations of the organizer concern primarily the protection of the rights and interests of passengers, in accordance with business practices, and informing about the rates, conditions and quality of transport and accommodation. The most important obligation of the passengers is the payment of the agreed price in the established time. In addition, the passenger is obliged to submit, in a timely manner, all the information necessary for the organization of the trip, and to take care personally, that his personal papers and his luggage meet the conditions provided for the border, customs, sanitary, monetary and other administrative regulations (article 894. and 895. ZOO). The passenger is liable for any damages done by non-performance of its obligations. If he's not able to in a timely fashion, or at all to fulfill its obligations under the contract, he is obliged to notify about it as soon as possible the organizer (article 898. ZOO). The provision of article 899. ZOO regulates that the passenger can specify another person to use agreed services instead of him, provided that this person meets the special requirements envisioned for a specific trip and if the passenger compensate costs caused by the replacement to the organizer. The right to increase the prices must be expressly provided for in the contract as well as the method of calculation of the increased prices. If the increase is more than 10% of the agreed price, the passenger has the right to terminate the contract without the obligation of compensation and the right to a refund of the paid price (article 900. ZOO). The passenger has the right at any time to the partial or complete termination of contract.

### **2.2. The package arrangement in the Law on the provision of services in the tourism industry 2007.**

The provision of paragraph 1 of article 5 ZPUT 07 has defined the passengers as the person who obtains a tourism service, the person for whose account and/or in whose name you are retrieving a tourist service or any person to whom you transfer the right of use of tourist services. Package arrangements or lump- sum travel was considered in advance determined

combination of at least two individual services that consist of transport, accommodation or other tourist and catering services which make up the whole, and stretch in time longer than 24 hours or includes at least one overnight, and are sold by total in advance established in advance (flat) price.

### **2.3. The package arrangement in the Law on the provision of services in the tourism industry 2017.**

The provision of point 1 article 7 of 17 ZPUT 17 determines that the travel service is considered a passenger transport, accommodation which is not an inseparable part of the passenger transport and it is not for the purposes of housing, rent a car, another motor vehicle with private drive and a minimum of four wheels with a speed in excess of 25 km/h or motorcycles for which driving licence of category A is required, and any other travel service that is not an inseparable part of the travel services in terms of passenger transport, accommodation, that is not an inseparable part of the passenger transport and is not for the purposes of residence, or renting a car, another motor vehicle with its own drive and at least four wheels with a speed in excess of 25 km/h or motorcycles for which driving licence of category A is required.. The provision of article 2, point 7. ZPUT 17 defines the package arrangement in a way that it means a combination of at least two different types of travel services for the needs of the same traveler vacation if that service combines one trader, among other, on request, or in accordance with the choice of the passenger before being assembled a unique contract for all services or independently of whether they are signed separate agreements with individual providers of travel services, if those services are buying on one sales point and if they are selected before than the passenger agreed to pay, offer, sale or charge by the flat or the total price, advertised or sold under the name "package-package" or a similar name, combine after the conclusion of the contract by which a trader gives the passenger a right to choose between the different types of travel services or buying from individual retailers via the related procedures online booking when the merchant with which it has concluded the first agreement delivered to the passenger's name, payment information, and e-mail address to another dealer or merchants, and a contract with the other merchant or merchants assembled is not later than 24 hours after the confirmation of the first travel services reservation. The provision of point 5 article 7 ZPUT 17 specifies that traveling in package-arrangement means a contract of a package-deal as a whole or, if the package-package provides under separate contracts, all contracts involving the services included in the package, travel-arrangement, while the provision of paragraph 4. specifies that start of the package arrangement means the beginning of the execution of the services included in the travel package-arrangement. It is important, also, to note the provision of paragraph 1 article 8. ZPUT 17, which specifies that the package arrangement will not be regarded as a combination of only one of the services passenger transport, accommodation, that is not an inseparable part of the passenger transport and it is not for the purpose of residence, rent a car, another motor vehicle with its own drive and at least four wheels with a speed in excess of 25 km/h or motorcycles for which driving licence category A and with any other tourist service that is not an inseparable part of the service travel if you don't make up a substantial part (25% or more) the value of the combination, if they are not advertised as a vital feature of combinations or in some other way represent the essential characteristic of the combination, or they are selected and purchased only after the start of the execution of the services of travel .

### **2.4 Linked travel arrangement in the Law on the provision of services in the tourism industry 2017.**

Provision of the point 5 article 7 ZPUT 17 defines the associated travel arrangement as at least two different types of travel services purchased for the purposes of the same travel or holidays that do not represent a package-arrangement, and which have the effect of making separate



contracts with individual service providers of travel if the trader when one visits to sales point or one contact with it allows passengers a separate selection and payment to each service separately travel or allows target purchase at least one additional travel services from another dealer if the contract with that other merchant is concluded no later than 24 hours after the confirmation of the first travel services. A combination of buying just one of travel services, will not be considered associated travel arrangement, specify the provision of paragraph 2. Article 8 ZPUT 17 if the services or services do not constitute a substantial part (25% or more) the combined value of the service and are not advertised as a vital feature of combinations or in some other way represent the essential characteristic of travel or vacation.

### **3. PASSENGER (CONSUMER) LEGAL POSITION IN PACKAGE TRAVEL REGULATIONS”**

Directive 90/314 determined a series of consumer rights in relation to travel in package travel. However, since its adoption market of travel services has significantly changed. The Internet has, in addition to traditional distribution chains, become an increasingly important channel through which the travel services offered and sold. The new rules include two types of contract, package arrangements (in advance agreed by a travel agency or customized by the traveler) and a new way of travel reservation which is called linked travel arrangement, and where users are guided by, for example, after have booked the flight, to book additional travel services through targeted online links. Travel and vacations in the package travel are complex combination of travel services, which usually include the services of transport and accommodation, and may include other services, like the car rental services and organize excursions. Since various service providers are often included, if there's a problem with one service, it can affect the other. Contacts with subcontractors to passengers can be difficult because of language barriers or cultural differences at the destination of travel, and in these cases, travellers will not have concluded the contract with the various service providers.

#### **3.1. Passenger (consumer) legal position in the Law on the provision of services in the tourism industry 2017.**

One of the most important area in which the extension of legal protection of the passengers in the new legislation is reflected, certainly represents more extensive and detailed regulation of the content of precontractual information. The Organizer, as well as the seller, if the package sales through the seller, shall, before the passenger agrees to any agreement about travel in package-or any arrangement with an appropriate offer, provide the passenger with appropriate legally binding standard information via the appropriate form (the provision of paragraph 1. Article 29. ZPUT), concerning the main characteristics of the travel, as well as the destination/destinations, plan trips and the period of stay, with dates and, if included, accommodation, the number of nights the involved, the means, characteristics and categories of transport, the place of departure and return with a date and in time or place, and the duration of the stop and transport links. If the time is not yet determined, the organizer and, where appropriate, the seller shall notify the passenger of the approximate time of departure and return, the location, the main features of and, where appropriate, the type and category of accommodation in accordance with the rules of the destination country, the diet plan, visit, excursion/shore excursions or other services included in the total price agreed upon for the package-arrangement. If it's not obvious from the context, information about if some of the travel services are provided within the group, and where possible, information on the approximate size of the group, if the use of tourist services depends on the effective oral communication, about the language in which these services will be provided, and whether the journey or holiday is generally suitable for persons with reduced mobility and, at the request of the passenger, precise information about the suitability of the travel or vacation, taking into

account the the needs of the passengers. The traveler should be also provided with information about the company and the geographic address of the organizer and, where appropriate, the seller, as well as their telephone number and, if applicable, e-mail address, as well as the total cost of the package-arrangements, including taxes and, where appropriate, all additional fees, charges and other costs, or, if those costs cannot be reasonably calculated prior to conclusion of the contract, an indication of the types of additional costs which will have to bear may be a traveler, methods of payment, the minimum number of persons required to the exercise of the package-the arrangement as well as the time limit within which the organizer may terminate the contract about the journey in a package before the start of the package. Passenger should be provided with general information on the requirements of the destination countries in connection with passports and visas, as well as information about the right of passengers to the passenger may terminate the contract at any time before the beginning of the package with the payment of adequate compensation for the termination of the contract or, where appropriate, the standard fee for breach of contract, required by the organizer. The obligation of the travel organizer in the package arrangement is also to inform passengers about the optional or compulsory insurance to cover the cost of the termination of the contract by the passenger or the cost of the provision of assistance, including repatriation, in the event of an accident, illness or death. All of the above information should be provided in a clear, understandable and easily visible way, and when rovided in writing must be legible and written in the Croatian language, or some other clear and understandable language to the passenger. Binding character of precontractual information, prevent their subsequent modification, unless the parties explicitly agree. In the traveling in package-arrangement contract or the certificate of the contract must be specified the full content of the agreement of the contracting parties, information about the special requirements of passengers which the organizer have accepted, responsibility of the organizer for the proper execution of all services included in the travel contract, the duty of the organizer to provide assistance to the passenger in difficulties (which have the character of a higher power), on the name of the insurer, as well as on available internal procedures for addressing complaints and mechanisms for alternative dispute resolution related to the contract, as well as about the authorized bodies for the alternative dispute resolution and on the platform for the online address these disputes, in accordance with the provisions of a special law on alternative resolving consumer disputes. The provision of paragraph 2 of article 36 ZPUT 17 provides that if the organiser before the start of the package is forced to significantly alter any of the main characteristics of the travel services, or can not meet the agreed special requirements of passengers, or propose an increase in the prices of package-arrangement for more than 8%, the traveller can, within a reasonable time determined by the organizer accept the proposed modification or terminate the contract without paying compensation for breach of contract. At the same time, the provision of paragraph 3 of article 900 ZOO 05 provides that if the increase in prices amountes to more than 10%, the passenger in this case has the right to terminate the contract without the obligation to compensation and with the right to a refund of the paid price. (Pešutić, 2009, p.138). Implementation of the directive (EU) 2015/2302 in the Croatian legal system with the adoption of ZPUT 17, in terms of the requirements for the passengers right to terminate the contract, lowers and narrows down the right of passengers (consumers), in comparison to the earlier mentioned solution from ZOO 05. The provision of article 43. provides the right of passengers to lower the prices, and the provision of article 44. guarantees the passenger the right to compensation caused by damage , regardless of the sale price or termination of the contract, and the right to demand from the organizers the appropriate compensation for any damage suffered as a result of any non-compliance, and the organizer is obliged to compensate the damage without undue delay. Provision of article 50 guarantees the passenger protection in the event of the insolvency The organizer of the package arrangement is insolvent in the event he is unable to timely payment of accrued liabilities in the amount and

within the due date or is in bankruptcy, which is the reason for travel services not running. The organizer is, required for each package arrangement to provide guarantee fund in case of insolvency by insurance companies or banks in the Republic of Croatia or another state of the European economic area, to retrieve the passenger of all the funds paid by the passenger or in the name of the passenger in connection with the journey in package arrangement for contracted services whose execution were absent, or which will not be made, or will only partially be made, due to the insolvency or bankruptcy. The guarantee fund covers the passenger fees for necessary costs of accommodation, meals and returning passengers to the place of departure in the country and abroad, as well as all resulting claims on that basis, that are caused due to insolvency or bankruptcy of the organizer, if the package arrangement included passenger transport. The organizer is obliged to ensure that the guarantee fund is effective and covers a reasonably foreseeable costs. The guarantee fund must provide refund paid for travel services that have not been completed, without undue delay after the request of passengers. The organizer is obliged to offer the passenger the insurance against accidents and illness while traveling, lost luggage, health insurance for the duration of the trip and the stay abroad, travel cancellation insurance which shall ensure the costs of assistance and the return of passengers to the place of departure in the event of an accident and illness, to make available information about the content of general terms and conditions of the insurance contract (provision of article 54. ZPUT 17).

#### 4. CONCLUSION

With regard to Directive (EU) 2015/2302 being based on method of maximum harmonisation (Tot, 2015., p.492), that required the Member States to prescribe effective, proportional, sanctions relating to infringements of the national provisions adopted pursuant to Directive because of stronger protection of passengers, the legislator decided to transfer Directive in the Croatian legal system through the new ZPUT. It was necessary to adapt the legislative framework to the market development in order to make it suitable for the internal market of the European Union, with the aim of removing the ambiguities and problems associated with application of the existing legal gaps related to consumer rights in relation to travel in package travel and related travel arrangements, and also adjusting the area of the protection of passengers with regard to the development of the Internet as a new medium through which to travel services online offer or sale, and to improve transparency and increase legal security for travellers and traders. With wider determination of the package travel, much more favorable for the passenger, it includes situations that were previously in a gray area of regulation or totally outside the scope. The new legislation clarifies the rules on package travel and beefs up consumer protection. With the amended definitions on package travel and linked travel it is now clear what package travel actually is. Benefits of the passenger (consumer) are clearer information requirements that include understandable information on package and passenger protection, stronger cancellation rights, free cancellation before departure due to force majeure, included, among other things. The passenger can now benefit from clearer terms of liability for booking errors, guarantees of money-back and repatriation. In cases where organiser goes bankrupt -these guarantees will be extended to linked travel arrangements in certain cases. Organiser now has the duty to offer assistance when passengers are in difficulty. But when it comes to the question of the organizers right to change prices, even though it is true that the new legislation offers more predictable prices to the passenger, due to the provision that stipulates 8% cap for possible price increases, before passenger can cancel free of charge, at the same time, the provision of paragraph 3 of article 900 ZOO 05 provides that if the increase in prices amounts to more than 10%, the passenger in this case has the right to terminate the contract without the obligation to compensation and with the right to a refund of the paid price. In terms of the requirements for the passengers right to terminate the contract, it seems that the

new rule of ZPUT 17 lowers and narrows down the right of passengers (consumers). Non-conformities in used terminology of ZPUT 17, although long present in the business practices of companies in the tourism industry, represent a disadvantage that should be removed as soon as possible. ZPUT 17 suffer, in general, from vastness, from definitions being too long and confusing, as well as from ambiguity of some of the legal solutions, which is primarily the consequence of transposing Directive (EU) 2015/2302 directly in ZPUT 17. In summary ZPUT 17, despite certain deficiencies, is the basis of the relevant legal framework for the development of services in the tourism industry that will allow a simpler implementation of legal provisions, better protection of the consumer, as well as enhancing the competitiveness of Croatian tourism.

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## PRINCIPLES FOR EFFECTIVE PUBLIC ADMINISTRATION UNDER MODERN CONDITIONS OF «TECHNICALIZATION» OF HUMAN ACTIVITY

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### **ABSTRACT**

*In modern conditions, human activity and their motives and purposes are closely connected with technologies and anthropogenic influence on the environment that cannot be neglected in the public administration. This is reflected in the scope of the public administration, or to be more precise, in its widening due to the incorporation of new kinds of human activities, methods of legal regulation, e.g. in employing various mathematical criteria (impact indicators) in normative provisions, legal language, for example, in terms (notions) used in law making and applying the law, as well as in the ways of representing legal prescripts, for example, in the use of charts, columns, graphs and other “non-standard” technical legal instruments of representing legal norms. The efficiency and effectiveness public administration is largely determined by its systemic nature, based on systems approach principles ranged from achieving practical objectives in biology to the analysis of systemic human impact on nature to modelling global development to organizing a space program to shipping and transport management. Public administration should comprise today the issues connected with administering the behavior of the subjects’ of law with regard to public relations in the industrial sphere and environmental control (ecosystems). In the 21st century anthropogenic impact, admittedly, is coming into the lime light. Its results and consequences, particularly in the long term, are rather difficult to forecast with scientific precision, forestall and eliminate. So the prognosis principles to measure the technology related impact on a human is one of the urgent issues for effective, good faith and responsibility public administration.*

**Keywords:** *Anthropogenic impact, Prognosis principles, Public administration, Systems approach*

### **1. INTRODUCTION**

Modern science in general and juridical science in particular pays a lot of attention to the area of principles for effective public administration and means of regulating the behavior of legal entities. Legal studies have always focused on various issues related to legal regulation of various activities, creating conditions that encourage good behavior in social relationships, and applying legal instruments that do not allow or repress antisocial behavior. According to law enforcement data, effective public administration is problematic today. The current principles for effective public administration implies that the legislator’s role and powers in regulating social relations and behavior should be considered in light of the fact that the Internet is the most frequent source of information that exerts real influence on legal entities. The motives, behavioral attitudes, and goals of legally relevant behavior of legal entities take shape in their legal consciousness in a certain socio-cultural context. This context also encompasses human activity in the industrial (technogenic) sphere and in the area of anthropogenic environmental impact. Thus, it is needed to reinterpret the public administration and means of legal regulation under modern conditions of “technicalization” of human activity. And the public administration studies systems approach is actual from both a theoretical and practical perspectives. The term “system” is widely used in public administration, for example: legislation system, public authority system, the system of legal regulation, judicial system.

However, in the examples given, as well as in other cases, the concept of system is based on the mechanistic approach. This is characteristic of the classical scientific rationality. The mechanistic approach leads to a certain kind of schematization (and, in this sense, simplification) of public administration, although it uses the term “system”. In particular, Russian legal studies consistently use the term “mechanism” rather than “system” to characterize the functioning of the state or the stages of legal regulation: the state mechanism and the mechanism of legal regulation, respectively. Nowadays, the systems approach focuses on the mode of a dialogue between the legal entity and the public administration system. Therefore, it helps to overcome reductionism (schematization) in the public administration sphere. It designs the public administration system, legal regulation, state authority, etc. as open complex systems interacting with the environment and affecting the designing process. The results of the designs the public administration, based on the systems approach, reflect the administrator’s position in terms of actual issues. The hypotheses generated by the administrator in the social and political context is determined (“programmed”) by the administrator’s comprehension, by the legal and political traditions in which they work, and by their surroundings, they were trained as an administrator. In terms of the area of principles for effective public administration, one of the problems associated with creating a modern legal regulation concept is the so-called “disappearance” of the subject of law. The individual as a subject of law - the actor subject - has “disappeared” from Post-Modernist philosophical and methodological studies. This has influenced the theory and practice of public administration, especially we consider the special methodological role of philosophy in human sciences and in practical aspects. In terms of theoretical methodology, this resulted in the “disappearance” of the individual subject (actor subject) from legal regulation research. In practice, the acting subject of law has gradually turned into an abstract person. Legal regulation is now directed at an abstract person’s behavior as if he were an object or thing. It is possible to overcome this tendency both in theoretical and practice-oriented public administration relying on a modern systems approach to legal regulation. It views an individual as a participant of the law making process, the holder of legal interest. It should also be mentioned that modern public administration systems approach is to carry out comprehensive research of diverse interconnections, relations and processes taking place in legal reality. The focus on self-assembling of systems, identification of probabilistic nature of their development is characteristic of synergetics, a study developing the provisions of the systems approach. Synergetics today is regarded as a general academic approach. Despite this fact, it defines the basic characteristics of the contemporary world view and society model. It would also serve the purpose of effective public administration under modern conditions of “technicalization” of human activity.

## **2. PUBLIC ADMINISTRATION AS A PROCESS OF REGULATORY INFLUENCE UNDER CONDITIONS OF TECHNOLOGY AND ANTHROPOGENIC DEVELOPMENT**

In modern conditions, public relations, a person’s socially significant behavior, and their motives and purposes are closely connected with technologies and anthropogenic influence on the environment that cannot be neglected in the area of public administration (Federal Law on Use of Nuclear Energy, 1995; Gorodov, Stafutina, 2010; Lakhno, 2014; Matiyaschuk, 2004; Redkin, 2008). This area should comprise the issues connected with administering the behavior of the subjects’ of law with regard to public relations in the industrial sphere and environmental control (ecosystems). Discussion of the current principles for effective public administration and means of legal regulation under modern conditions of “technicalization” of human activity puts forward problems of interaction between legal entities, meanings and correlations between legal consciousness and legal principles during information transmission (mutual influence,

leverage) in the area of public administration. Currently, scientific experts recognize various processes of influence such as moral, psychological, ideological, physical, and processes of regulation such as technical, governmental, regulatory. Legal consciousness and legal principles, legal ideas and values of legal culture do not immediately regulate behavior, people's performance, and their interrelations and connections. They influence the character of regulatory administering and determine its effectiveness.

## **2.1. The character of public administration as a process of regulatory influence**

Natural sciences and social humanities define influence, impact, regulation as a process of transmitting information. Attention is focused on the thrust of influence (pressure) and its results and effectiveness. Impact is a kind of influence that (to a certain extent) brings about changes in a system or subject (object) directly or indirectly (partially) targeted. Semantics of the word “vozdeistvie” in Russian imply that the idea cannot be without result, having no effect at all. Subject, object, or system (either natural or social), being under the direct influence (active pressure), is considered to be under action. Changes in the system which resulted from some kind of active pressure, for example, changes in the legislation or administration of law, eventually have influence (impact) on the functioning of the system and induce consequential changes in this system. Feedback is not considered an essential feature of influencing, yet it supposedly might exist. If any feedback occurs, the interaction (mutual influence) is between the party applying leverage and the party being under influence. Influence emerges in a particular dependence of properties, behavior, state, characteristics etc. of a subject, object, or system on the influence they experience. Under this influence, a natural or social system might transfer from one state to another, and change its properties and functional features. There exist some distinguishable forms of influence. Depending on the purpose it might be either managing or spontaneous, or so-called “perturbative” (Dictionary of mathematics for economists, 2003). Concerning the character of influence, both kinds of impact might be non-recurrent, periodical, or constant. Continuous influence might be systematic (regularly repeated) and sporadic. In accord with the character of influence, its results are predictable (expected) to a certain degree of probability. Based on the parameter of duration, two forms of influence are distinguished, namely, momentary and continuous impact. Extended in time (continuous) impact might be of systemic character: it represents a consecutive change of definite phases of influence aimed at gradual sequential realization of a particular result. The form of focused administering is regulating. Regulating (from lat. *regulo* - arrange, put in order), is understood as the process of influencing, it aims to administer behavior, relationships, and interactions of people. Changing specific properties, characteristics in the area of public administration system might be one of the tasks of regulation. Public administration has to be focused on maintenance of social sustainability and balanced development. The distinctive feature of public administration is that regulating is executed by means of norms and rules included in the system. Public administration presumes estimation of definition of its goals and principles of its functioning. It is aimed at normalizing behavior and the performance of subjects and their relationships. It should be noted that being of Latin origin the word “regulation” is associated with instruments of normative nature such as rules, orders, and decrees regulating activities and relationships. Public administration includes legal regulation dealing with different forms of regulation (including self-governance) of actions, directions of activities and interrelations between people in different domains. Legal governance are performed by stating the tasks, estimating desirable results (effectiveness), and designating suitable methods to realize them. Being a form of targeted influence, legal regulation might be executed: either in the direct form of managing behavior of people by setting concrete tasks and indicating the ways to fulfil these tasks; or in normative (abstract) form connected with establishing principles and generic models (norms, rules) of conduct and interaction between people.



Public administration might aim at providing the possibility for an enterprise to form the conditions which stimulate desirable, socially beneficial behavior and restrict, prevent, suppress harmful activities, offensive behavior. Consequently, information transmitted in textual form in the process of regulation has to influence people in such a manner that it will form in their consciousness motives and attitudes pertinent in the context of the regulation's goals. In the case of government regulation, impact transmitted is effective and efficient if law making and law enforcement are legitimated by people. Legitimation means that people consider regulations to be the basis of their behavior and relationships and form the motives for their lawful (desirable for a governmental agency) behavior.

## **2.2. The prognosis method as principle for effective, good faith and responsibility public administration under modern conditions**

Concerning the effects of the influence exerted two types of impact are recognized, namely, harmful (negative) and beneficial (positive) impact. Contemporary science pays serious attention to the prognosis method and its application to issues connected with possible harmful effects (including distant in terms of time and space) of different kinds of both targeted and repetitive influence and elemental influence. The prognosis method is essential for effective public administration and definition of means of legal regulation. The prognosis of consequences and results of an action of certain institutions is essential for effective public administration. A negative (harmful, destructive) impact is considered to be: influence on a social system, provoking disfunction of the system; impeding transmission or perception of information; and disrupting established (and in this sense, normal) regulating of relationships between people. For instance, influence of political and economic factors under specific socio-cultural conditions might prevent realization of principles of legal freedom and legal equality for the sake of social adjustment of particular groups of citizens. Depending on an information transfer form, impact can be distant (indirect) or so-called contact, i.e. immediate. In the process of distant influence, information is transmitted by means of signs, symbols, texts, signals with certain meaning that produces an impact. Comparative analysis of the states, properties, relations and processes before and after the influence allows to estimate the effectiveness of impact, its positive or negative character. Such natural phenomena as heat, alidity, bursts of wind, precipitation, atmospheric pressure, seismic anomalies, etc. have an elemental effect on humans. The influence they have on social behavior, human activities, and public relation is irrational. The impact of natural phenomena on humans is connected with physical, chemical, physicochemical, biological or other (natural) factors. As a rule, their influence is of a regular and repetitive character. Interestingly, time itself is considered as a factor of natural (physical) impact on a person, and their behavior, consciousness, and health. Contemporary science makes an effort to increase life expectancy, and to delay the natural aging processes of a human body. Influence of time is significant with regard to objects and phenomena of a material world: methods exist to estimate changes of properties of various materials in time (GOST 31384-2008, 2009). It is the task of science to work out methods to identify factors of environmental impact, and to anticipate its results and consequences, i.e. natural regular patterns, constant cause-effect links between natural phenomena activities and consequences of these impacts. In some cases, consequences and results of the influence of natural factors can have legal value and exert an impact on legal relationships. For example, floods, earthquakes and other natural disasters might affect the legal status of citizens caught in the disaster area if a regime of public emergency is implemented in a zone of natural disaster. A strong influence of natural phenomena factors can be traced in the sphere of legal regulation of health care. There are problems connected with providing particular groups of the population with obligatory vaccination, smoking in public places, and other current problems of the National Health System.

It is possible to resolve them due to analysis and prognosis of harmful effects of different physicochemical, biological and other natural factors. The technology related influence is characterized slightly differently for its different factors, anthropogenic systems, etc. as they are virtually man-induced. Technosphere is a result of scientific and technological advances, interference with natural environment. Anthropogenic impact might directly result from human activity, or might result from exploiting various technologies. In the 21<sup>st</sup> century anthropogenic impact, admittedly, is coming into the lime light. This impact might be positive or harmful for a human and the social system. Its results and consequences, particularly in the long term, are rather difficult to forecast with scientific precision, forestall and eliminate. The elaboration of prognosis methods to measure the technology related impact on a human is one of the urgent issues that should concern contemporary science. It might be most challenging to apply these methods to medical, pharmaceutical and other technologies which have a direct impact on the human body. Although the issue is the application of prognosis methods for modelling the consequences of an individuals' behavior, modern society puts forward strict demands to individuals with respect to their ability not only to judge their behavior but also estimate possible effects of this behavior both in the short-term and in the long-term. In this respect, the strictest requirements are imposed on the professional activity of doctors and possible consequences of their behavior.

### **3. MODELING PUBLIC ADMINISTRATION AS AN INTEGRATIVE AND HOLISTIC SYSTEM FOR EFFECTIVE GOVERNANCE UNDER CONDITIONS OF «TECHNICALIZATION» OF HUMAN ACTIVITY**

In the area of public administration systems approach characterizes its main principle. The systems approach promotes for effective public administration particularly actualizing the role and importance of the legal entity in legal regulation, in the processes of law establishing. The public administration systems approach focuses on the legal entity as a party of legal life of society, hence its interactive nature. The systems approach principle is reflected, in particular, recognizes that positive law gives privileges, although they inherently contradict the law, the legal regulation between different (but equal to each other in the legal sense) legal entities. The main principle of public administration systems approach is the principle of a comprehensive view on public administration. That is representation (modeling) public administration as an integrative and holistic system. This kind of public administration combines regulation means developed in both legal and other (non-legal) areas of regulation. The impacts that natural phenomena have on humans and the impacts that human activities have on the natural world are the subject of scientific research. The conception of public administration system integrates findings and conclusions of research in natural science in order to formulate requirements imposed on people: common sense/rationality, good faith and responsibility for negative consequences of their behavior.

#### **3.1. Mathematical equations and calculations and other “non-standard” technical legal instruments in the area of public administration**

Detected consistent patterns of natural (natural standards) and technology related (technical regulations) impact are formulated by means of various mathematical equations, formulae, graphs, etc. Based on the established consistent patterns and the formulated technical norms, calculation is made for the impact of natural and technology related factors. An example is the influence of temperature and humidity conditions on a particular groups' health, and conditions of building parts. Measurements and calculations of the actions of these factors enable evidence-based forecasts to be given of the results and consequences of these factors' impacts in time (for example, changes of properties of construction materials and medication) and space. Such calculations provide for the prevention and avoidance of harmful effects of anthropogenic

influence in a number of cases. They are instruments to regulate human activity. Measurements and calculations of the influence of environmental and technology related factors (On Approval of the Rules for the Wholesale Electricity and Capacity Market and on Amending Certain Acts of the Government of the Russian Federation on the Organization and Operation of the Wholesale Electricity and Power Market, 2010; On the marginal levels of tariffs for electricity and heat, 2003) are enshrined in legislation in the form of technical laws and in this manner have a legal impact on human behavior. Influence of factors calculated by means of mathematical equations might be called impact (from English impact – kick, effect, influence, impression). For example, metering of natural and anthropogenic impact is executed in the domains of transportation and energy production (nuclear power industry, electrical power industry). This is currently one of the most important branches of legal regulation (both in national and international law) (On the electric power industry, 2003; About governmental regulation of tariffs for electricity in the Russian Federation, 1995; About amendments in Russian legislation concerning saving energy, 2009; Gorodov, 2015; Lakhno, Zekker, 2011; Svirkov, 2013). In order to perform such metering, corresponding scientific and technical documentation is elaborated. This documentation defines impact as physical action in a form of mechanical/ environmental influence on buildings, constructions, systems, systemic elements, and the staff of nuclear power stations, the population and environmental objects. It should be noted that mathematical calculations are widely applied to estimate not only environmental or anthropogenic impact, but also economic (Pogorlecky, Dolgopolova, 2011), managerial, social and psychological, linguistic, juridical, and informational kinds of impact. Impact indices exist for possible accidents and their effects in the domain of cybersecurity. In order to prepare a company for different incidents, integrative management systems imply analysis of impacts of positive and negative influence of different factors on the liabilities and policy of an organization with respect to its business steadiness and riskiness. In the system of management, impact on risks might be used to “moderate” or decrease the probability of its occurrence, or in order to eliminate or prevent risks (Rozhdestvenskaya, 2011, pp. 12-18; Rozhdestvenskaya, 2011, pp. 129-134). At the same time, impact on a risk can create new risks or change the existing risks. Principles of influencing a risk treatment urge the system of management either to eliminate risk factors, or to accept a risk (or even increase it) and finance it in order to create a favorable situation. Moreover, in the system of management one of the ways to impact a risk is by sharing it with the other party of the contract. (Rozhdestvenskaya, 2012; GOST R 53647.4-2011, 2011; GOST R ISO 31000-2010, 2010; GOST R 52806-2007, 2007). At present, impact indices are widely used in scientific research and education. For instance, the so-called impact factor of a scholarly journal allows to estimate its popularity by means of numerical measurement. The impact factor of a scholarly journal is based on an average number of citations of the published articles, and it allows to present a hierarchical system of ratings. The actual impact factor is supposed to influence publication activity and to stimulate them to publish their article in highly rated journals. Furthermore, the impact factor of a journal might have legal (juridical) impact when it is used as a criterion for payment or during selection of candidates to research fellowship and teaching positions at universities. The modern public administration system, undoubtedly, should integrate the regulation of environmental issues. Environmental aspects of the parties to legal relations, activities and behavior are connected with environmental impact, which causes positive and negative changes in the ecosystem. Legal regulation of human activity and impact on the environment is directly aimed at social relations in the domain of goods production (Gorodov, 2012), providing different services (for example, transportation), and scientific research activities such as exploration of space, Arctic and Antarctic, investigation of the World Ocean, and usage of nuclear power (For example, Federal Law “On the use of nuclear energy”, 21.11.1995, № 170-

Ф3 // Collection of Legislative Acts of the Russian Federation 1995. № 48. art. 4552. (as amended and supplemented 03.07.2016).

### **3.2. Systems approach principles for effective public administration**

Public administration in the technology related domain – where humans and nature have mutual influences – is bound to rely on systemic analysis. Conception of public administration comprises: aims of governance; methods to realize these aims, including alternative ones; expected results; and possible risks connected with particular ways to achieve the aforementioned aims. Principles of systemic analysis allow to choose the form of governance which is the most appropriate for concrete socio-cultural, political, and economic conditions in a particular sphere of social relations on the basis of comparison of anticipated results and possible risks. Governmental regulation should correspond to environmental and technology related requirements, resulting from elemental patterns such as innate constituents of life sustaining or production related technological processes (On the case about the inspection of constitutionality of clause 5, article 20 Federal Law "On governmental regulation of production and turnover of methyl alcohol, alcohol and spirit containing produce and limitation of consumption (drinking) of alcohol containing produce" connected with the appeal of "SGIV" Ltd, 2016). Synergetic is used in jurisprudence, yet the synergistic direction emerged in natural science (as well as the systems approach). In the most general sense, is non-linear thinking and, as a consequence, a probabilistic picture of the world. Any system seeks to preserve equilibrium with the environment. Complex open systems, including social systems, exist in unstable equilibrium conditions. The more complex a system is, the harder it is to maintain equilibrium. The external environment “threatens” the existence of the system. Therefore, one of the most important issues of synergetics is the problem of transforming chaos into order and vice versa, i.e. a complex system self-assembling. The synergistic approach creates a new view on law as an unstable, constantly emerging subsystem of society. However, it is the legal system that can ensure the wholeness of society through legislative regulation. Synergetics is exploring the links between the elements of the structure of open systems, especially, biological, physical and chemical. The conclusions on self-assembling in open biological, physical and chemical systems, made by synergetics, are based on: thermodynamics of nonequilibrium processes; the theory of random processes; and the theory of non-linear oscillations and waves. Natural scientists discovered that self-assembling in open systems meant a consistent behavior of the subsystems, increasing the degree of orderliness, and decreasing entropy. Formation of a systemic conception of governance, taking into consideration the universal panoptic character of anthropogenic (human and machinery related, scientific and technical) and environmental domains (conservational) of social relations, presumes analyzing a large amount of evidence, circumstances, facts, and their interconnections. Public administration activities are performed with the use of computer programs based on the generic principles of management systems and cybernetic advances connected with transmission and perception of information in the process of regulation. Interdisciplinary nature of the systems approach results in a multiplying holistic public administration. It ensures the unity of the regulation means used, and the connection of different models of regulation, self-regulation through the administration systems approach. Herewith, public administration is as a complex socio and political whole. Its functioning is impossible without legal entities. From linguistic relativity hypothesis point of view, it is not reality that determines the language spoken, but, on the contrary, reality is mediated by our language. Herewith, modern reality is transforming into virtual reality, the Internet reality. The real modeling of public administration is possible only in a conversational mode when not only an administrator influences social relations system as the object of regulation, but a social relations system also influences the administrator. The administrator is a member of society, a citizen. He is a participant of public administration.

Therefore, the result of the public administration, its model is influenced by the administrator's “attitude” (prior comprehension) towards the concept of public administration, legal regulation, legal rules. (Bo Stråth, 2000). The administrator's comprehension is a prerequisite for their views on the issue of principles for effective public administration.

#### 4. CONSLUSION

Humanity creates administration institutions, changes them, “participates” in them (Rulan, 1999) and explores them. The involvement of legal entities in legal, administration and other social institutions, their participation in legal regulation and public administration may cause some skepticism regarding the feasibility of presenting modern social relations as managed. It may also challenge the possibility of purposeful and centralized organization of legal entities' conduct (especially in the information space of the Internet) as well as prediction of public administration effectiveness. The public administration systems approach obliges administrators to take into account the social processes of self-assembling and self-regulating. On the one hand, the systems approach principles in relation to the area of public administration helps to overcome the skepticism about the possibility of effective public administration and legal regulation under contemporary conditions, for example, in the Internet. On the other hand, it overcomes a schematized designing of the public administration as a state regulation mechanism. Also, it allows the consideration of public administration as a complex system, identifies actual goals of public administration and its means. The systems approach implies the forecasting possible changes in the area of public administration and means of regulating the behavior of legal entities. Current anthropogenic impact, as a rule, is closely connected to technological influence on the environment since practically all kinds of human activity are technologized. Such impact might be direct (straightforward impact) or indirect. An example of direct impact is drainage of a natural water body; and examples of indirect impact are usage of water and air transport, and exploitation of the World Ocean, space, Arctic and Antarctic (For example, there is the section of legislative ensuring for social and economic development of the Arctic zone of Council for the Arctic and Antarctic which is directed by the Chairman of Committee of the Federation Council by the constitutional legislation and the state construction affiliated to the Federation Council of the Federal Assembly of Russia.). Human influence on the environment is rational and regular; therefore, it has to be grounded on established technical regulations and subjected to systemic public administration to be efficiency and effectiveness. Public administration in the sphere of ecological relations should be based on impact indices comprising different aspects of human activity and allowing to estimate the risks of technologies and anthropogenic impact on the environment. The aim of modern public administration approach is to include specific rules and corresponding impact indices of technologies and anthropogenic impact on the environment in the regulation system. These rules and indices have to be systematically implemented by people, which is possible when they recognize the value of the ecosystem. One of the methods of law making in the sphere of anthropogenic impact on the environment is formulation of federal standards, which manufacturers can join on a voluntary basis. It is legally binding for the people involved in licensed industrial activity to accept and follow government standards in their daily practices. Violation of the government standard requirements serves as grounds to inter alia suspend or terminate people's activity. Since negative consequences of the anthropogenic influence result from natural patterns of functioning of the ecosystem, it is not always possible to eradicate these negative consequences and restore fully environmental interconnections. Negative (harmful to environment) anthropogenic impact on the environment might cause significant, or even irreversible, changes of environment, and consequently induce a negative impact on humans who are considered a part of the environment in a wider sense. Measures of penal treatment legal responsibility (material or personal) per se cannot reconstruct ecological interconnection

and balance of ecosystems. Public administration in this sphere is effective if a behavioral paradigm of lawful behavior is formed in the consciousness of people. The parties to legal relations observe ecological rules by including them in contracts and self-management based on juridical traditions. Effectiveness of governmental regulation in the domain of environmental relations is determined by the processes of integrating ecological norms into agreed common rules established by the participants of: industrial relations; relations in the sphere of scientific research and practice; and other relations influencing the ecosystem.

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## STATE OF THE EARLY STAGE MARKET IN CROATIA

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### ABSTRACT

*The availability of various sources of funding for start-up, development and growth of entrepreneurial activity is very limited in Croatia. The financial market for entrepreneurial project in Croatia is still traditional. Bank and credit union loans, government incentive programmes and subsidised credit lines dominate over alternative sources of finance like venture capital and business angels. Furthermore, Croatia records low availability of non-traditional sources of financing for small and medium enterprises during the entire period of the GEM research period from 2002 till 2016. The activity of business angels, early venture capital and crowdfunding on the domestic market are still small and at early stage of development ie the market is underdeveloped. The goal of this paper is to examine and analyze the presence, current state and the importance of the early investment market in Croatia.. The research is both qualitative and quantitative and involves an identification, analysis and research on the early stage investment market in Croatia. The data for business angels and early venture capital are shown for the period from 2008 to 2015, while the period for crowdfunding is from 2014 to 2016. The data necessary for the current research were taken from three different public available sources.*

**Keywords:** *business angels, Croatia, crowdfunding, venture capital*

### 1. INTRODUCTION

The early stage market in Europe includes three main areas. Those areas are investments made by business angels, early stage VCs and equity crowdfunding (EBAN, 2017, p. 7). Business angels represent wealthy individuals who invest their own money, time and knowledge directly in new and emerging companies, unlisted, with no family connection with a goal of future financial earnings (EBAN, 2009, p.7, Iruarrizaga and Santos, 2013, p. 182, Mason, 2011, p.1, Mason et al, 2016, p. 322, Mason and Botehlo, 2014, p. 4, Etula, 2015, p. 14, Capizzi et al, 2016, p. 3, CEPOR, 2017, p. 57, European Commission, 2018a, p. 1), while venture capital consists of financing young, unquoted companies by professional investors or funds through equity or equity liked instruments (Wright and Robbie, 1998, p. 521, Bottazzi and Da Rin, 2002, Hudson and Evans, 2005, p. 1). Crowdfunding is an alternative source of finance where a small amount of money is provided by large number of individuals through a mobile phone or online platforms for different needs. One type of crowdfunding is equity crowdfunding which characterizes investments of a broad group of investors in start-up companies and small businesses in return for equity (CrowdfundingHub 2016b, p. 4, Zhang et al, 2016, p. 31, World bank, 2013, p. 20, Delivorias, 2017, p. 2, Manigart et al, 2013, p. 32). The value of the market in 2016 in Europe was 9,9 billion euro (EBAN, 2017, p. 7) and it grows from year to year. In Croatia, the availability of various sources of funding for start-up, development and growth of



entrepreneurial activity is very limited (CEPOR, 2017, p. 40). The financial market for entrepreneurial project in Croatia is still traditional. Bank and credit union loans, government incentive programmes and subsidised credit lines dominate over alternative sources of finance like venture capital and business angels. Furthermore, Croatia records low availability of non-traditional sources of financing for small and medium enterprises during the entire period of the GEM research period from 2002 till 2016 (CEPOR, 2017, p. 40). Business angels in Croatia are still an unknown source of external financing for entrepreneurs. The activity of business angels on the domestic market are still small and at early stage of development (Mason, 2016, p. 363), i.e. the market is underdeveloped (European Investment Bank, EIB, 2015, p. 90). An additional reason for the underdevelopment stems from the fact that most of the economy is based on tourism, while the potential of enterprises with innovative ideas and young people is still not explored (EC, 2017). Although, the development of VC market in Croatia started at the end of the nineties with the appearance of foreign PE/VC funds<sup>1</sup>, the market is still underdeveloped and VC does not yet play a significant role as in some developed countries. Also, crowdfunding as an alternative source of finance in Croatia is in an early phase of occurrence. Whole range of limitations limit its use like (CrowdfundingHub, 2016a, p. 21): small awareness of possibility of crowdfunding, poor development and mistrust of e-business and low use of Internet. The goal of this paper is to examine and analyze the presence, current state and the importance of the early investment market in Croatia. The research is both qualitative and quantitative and involves an identification, analysis and research on the early stage investment market in Croatia. The data for business angels and early venture capital are shown for the period from 2008 to 2015, while the period for crowdfunding is from 2014 to 2016. The data necessary for the current research were taken from three different sources. Data for business angels were taken from the SMEs and Entrepreneurship Policy Centre (CEPOR) report 2016. Data for early stage venture capital were collected from the public available yearbook of EVCA/PEREP Analytics for 2015, EVCA special paper – Central and Eastern Europe Statistics 2014, EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y, EVCA (2015) and Invest Europe (2017). Data for crowdfunding were collected from Crowdfunding.hr which is a blog about crowdfunding in Croatia and World

## **2. EARLY STAGE MARKET -THEORETICAL APPROACH**

### **2.1. Business angels**

Business angels can be defined as wealthy individuals who invest their own money, time and knowledge directly in new and emerging companies, unlisted, with no family connection with a goal of future financial earnings (EBAN, 2009, p.7, Iruarrizaga and Santos, 2013, p. 182, Mason, 2011, p.1, Mason et al, 2016, p. 322, Mason and Botehlo, 2014, p. 4, Etula, 2015, p. 14, Capizzi et al, 2016, p. 3, CEPOR, 2017, p. 57, European Commission, 2018a, p. 1). Mason (2016, pp. 28-29) highlights four features that are fundamental to business angels and their investments, and which differentiate them from other types of investments. These are:

- Business angels invest their own money.
- Invest in private companies that are not on the stock exchange.
- Investing takes place directly or through the emergence of networks and business angel groups, the business angel independently decides to invest.
- The business angel's investment primarily requires a financial return.

During the last few years business angels and their way of acting, either as individuals or as a member of a group/network, are in the focus not only by scientists and financial institutions, but also by regulators and policy makers (Capizzi et al, 2016, p. 3).

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<sup>1</sup> These funds, SEAF Croatia, Horizonte Venture Management, Copernicus Capital, Vienna Capital Partners, were organized as local consulting companies of foreign PE/VC management companies (Rončević, A., 2008, p. 112).

The reason for the focus stems from the fact that business angels are the main source for financing start-ups in Europe (EBAN, 2017, p. 6, Mazzone, 2014, p. V), which is consequently crucial to the development of economic and social systems (Capizzi et al, 2016, p. 3). The importance of business angels also arise from the fact that business angels invest locally and so resolve the regional financial gaps for early stage companies (Manigart et al, 2013, p. 34). Furthermore, business angels represent a large segment of venture capital industry (Capizzi et al, 2016, p. 3, Manigart et al, 2013, p. 34). During 2016 in Europe, around 9.9 billion euros of capital were invested in early development, of which business angels invested 6.7 billion euros, while the rest made early stage venture capital (2.5 billion euros) and equity crowdfunding (0.7 billion euros) (EBAN, 2017, p. 7).

## **2.2. Venture capital**

According to Wright and Robbie (1998, p. 521) venture capital can be defined „as the investment by professional investors of long-term, unquoted, risk equity finance in new firms where the primary reward is an eventual capital gain, supplemented by dividend yield, while by Bottazzi and Da Rin (2002, ) venture capital „consists of financing young, unlisted dynamic ventures through equity or equity-like instruments by limited partnerships of professional investors who raise funds from wealthy and/or institutional investors“. Hudson and Evans (2005, p. 1) define venture capital as „an independently managed, dedicated pool of capital that focuses on equity or equity-like investments in privately held, high-growth companies, while according to Croatian Private Equity and Venture Capital Association (CVCA, 2018, p.1 ) venture capital is the „sub-universe of equity investments in private companies referring to early stage, start-up and expansion capital“. According to these definitions few common elements of venture capital can be marked:

- an equity investment,
- by professional investors
- in young unquoted companies.

## **2.3. Crowdfunding**

The financial crisis in 2008 further increased the financial gap for early-stage companies. As an response for this situation appeared crowdfunding as an online extension of financing by friends and family (World bank, 2013, p. 14). Although, crowdfunding is a relatively new type of financing (Delivorias, 2017, p. 1), during the last few years it is growing rapidly (Jenik et al, 2017, p. 17, Kirby and Worner, 2014, p. 12).

Crowdfunding definition vary from author to author, from country to country, but generally crowdfunding can be define as an alternative source of finance where a small amount of money is provide by large number of individuals through a mobile phone or online platforms for different needs (GPFI, 2016, p. 64, Jenik et al, 2017, p. 1, Kirby and Worner, 2014., p. 8, European Commision, 2018b, p. 1, Delivorias, 2017, p. 2, World bank , 2013, p. 8)

Source: author's compilation base on different sources

Key common components for crowdfunding are (Jenik et al, 2017, p. 2):

- raising funds in small amounts,
- from many to many,
- using digital technology.

According to CrowdfundingHub (2016a, p 9) it is difficult to follow and to compare data and research about crowdfunding in different countries, due to the lack of an unique taxonomy. In use are different terms like crowdlending, crowdfinance and crowdinvesting which are not define on the European level and have distinct meaning in separate countries. Different types of crowdfunding exist depending on what investors receive in return for their contributions

(CrowdfundingHub, 2016a, p 9, Zhang et al, 2016, p. 31, World bank, 2013, p. 20, Delivorias, 2017, p. 2, Manigart et al, 2013, p. 32):

- Donation based crowdfunding (no reward is received by people for their contribution),
- Reward based crowdfunding (goods and services are received by people in exchange for contribution)
- Lending based crowdfuding (people receive for their contribution interest payments)
- Equity based crowdfunding (people receive for their contribution shares in the venture).

The reward and donation based crowdfunding fit the phases idea/inception and prototyping, while an equity and debt base crowdfundig is suitable for the startup phase. In this phase, business angels can also be an important source of finance (Figure 1). Since the equity based crowdfunding is a part of early stage investment further emphasis will be put on this type of crowdfunding.

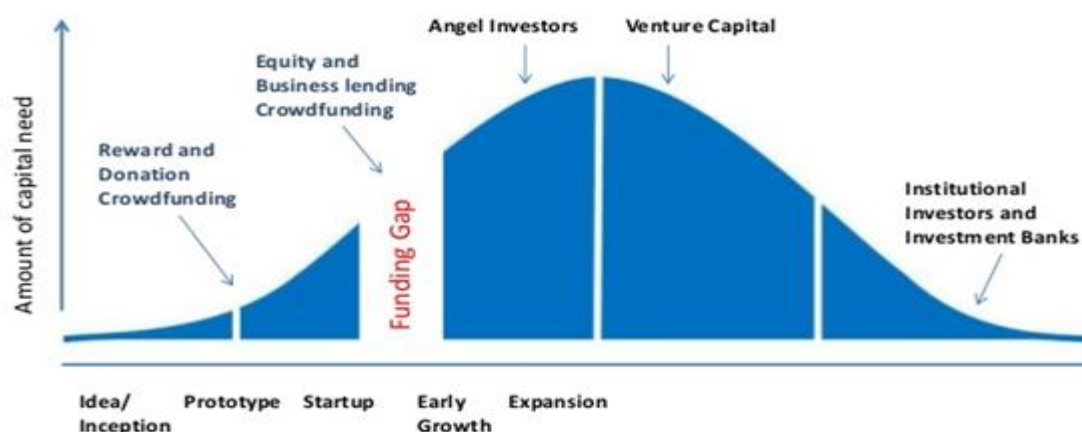


Figure 1: Crowdfunding on the Funding Lifecycle (World bank, 2013, p. 16)

Zhang et al (2016, p. 31) define Equity based Crowdfunding as „ Individuals or institutional funders purchase equity issued by a company“, while according to CrowdfundingHub (2016b, p. 4) equity crowdfunding „ is a mechanism by which a broad group of investors can fund start-up companies and small businesses in return for equity“. Furthermore, „ Equity crowdfunding allows individual and institutional investors to invest in unlisted entities (issuers) in exchange for shares in the entity“ (Jenik et al, 2017, p. 17). The market volume of the Equity based Crowdfunding in Europe in 2015 was 159, 32 million euro (Zhang et al, 2016, p. 31).

### 3. STATE OF THE EARLY STAGE MARKET IN CROATIA - THEORETICAL APPROACH

In Croatia, the availability of various sources of funding for start-up, development and growth of entrepreneurial activity is very limited (CEPOR, 2017, p. 40). According to CEPOR (2017, p. 40) the financial market for entrepreneurial project in Croatia is still tradionional. Bank and credit union loans, government incetive programmes and subsidised credit lines dominante over alternative sources of finance like venture capital and business angels. Furthermore, Croatia records low availability of non-traditional sources of financing for small and medium enterprises during the entire period of the GEM research period from 2002 till 2016 (Singer et al, 2012, p. 78, CEPOR, 2017, p. 40). Business angels in Croatia are still an unknown source of external financing for entrepreneurs. The activity of business angels on the domestic market are still small and at early stage of development (Mason, 2016, p. 363), ie the market is

underdeveloped (European Investment Bank, EIB, 2015, p. 90). An additional reason for the underdevelopment stems from the fact that most of the economy is based on tourism, while the potential of enterprises with innovative ideas and young people is still not explored (EC, 2017). According to CEPOR (2007, p. 27) the number of business angels in Croatia is lower in relation to GEM EU average. The Croatian business angel network (CRANE) is trying through its activities to increase the awareness of the importance and existence of business angels in Croatia, as well as market development. CRANE brings together private investors, successful entrepreneurs and leaders from both Croatia and abroad, who show interest in investing in innovative companies in the early stages of development (CRANE, 2018, p. 1). CRANE was founded in 2008 as a joint initiative of partner institutions Poteza Ventures, Croatian Private Equity and Venture Capital Association Agency for Export and Investment Promotion, , Association for promoting software and online entrepreneurship ‘Initium,’ and of a successful entrepreneurs Damir Sabol and Hrvoje Prpić. Although, the development of VC market in Croatia started at the end of the nineties with the appearance of foreign PE/VC funds, the market is still underdeveloped. In 2003 the first Croatian PE/VC management company were established under the name Quaestus Private Equity Ltd. which manages the fund Quaestus Private Equity Kapital (Šimić Šarić, 2017, p. 202). During 2011 five Economic Co-operation Funds (ECF) complied the procedure of establishment and received from Croatian Financial Services Supervisory Agency (HANFA) a work permit. In 2018, four alternative investment capital management companies exist in Croatia: Quaestus Private Equity Ltd., Nexus Private Equity Partneri Ltd., Prosperus-invest Ltd and Honestas Private Equity Partneri d.o.o. Despite the presence of VC in Croatia for more than 20 years, VC does not yet play a significant role as in some developed countries. There is an interest for crowdfunding in Croatia, crowdfunding as an alternative source of finance, is also in an early phase of occurrence. Whole range of limitations limit its use like (CrowdfundingHub, 2016a, p. 21): small awareness of possibility of crowdfunding (Figure 2), poor development and mistrust of e-business and low use of Internet. Croinvest and Croenergy are two Croatian crowdfunding platforms. Croinvest combines five model of financing (donations, awards, loans, ownership participation and profit participation), while Croenergy is donated based platform exclusively for sustainable energy and environmental protection projects.

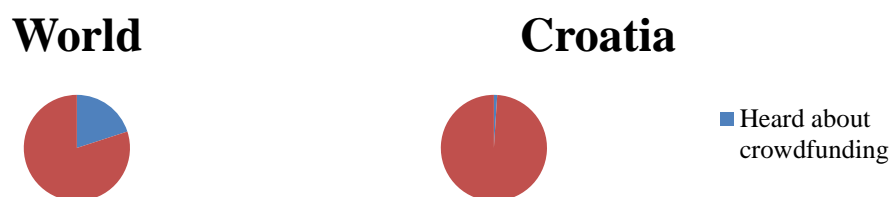


Figure 2: Familiarity with crowdfunding in the World vs Croatia (author according to Maras, 2015, p. 3)

#### 4. METHODOLOGY

The research is both qualitative and quantitative and involves an identification, analysis and research on the early stage investment market in Croatia. The data for business angels and early venture capital are shown for the period from 2008 to 2015, while the period for crowdfunding is from 2014 to 2016. The goal is to show the presence and state of the early investment market in Croatia. Figures are used to visualize the time series and trends in observed variables. The data necessary for the current research were taken from three different sources. Data for business angels were taken from the SMEs and Entrepreneurship Policy Centre (CEPOR) report 2016. Data for early stage venture capital were collected from the public available yearbook of EVCA/PEREP Analytics for 2015, EVCA special paper – Central and Eastern Europe Statistics

2014, EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y, EVCA (2015) and Invest Europe (2017). Data for crowdfunding were collected from Crowdfunding.hr which is a blog about crowdfunding in Croatia and World. Collected data were processed using descriptive statistics.

## 5. RESULTS

### 5.1. Descriptive statistics for business angels in Croatia

In the observed eight-year period, only 15.5 million kuna were invested from side of business angels in Croatia. The peak of the investments was in 2008 followed by a significant fall in investment in other years (Chart 1). Looking from the aspect of total number of investments the peak was in 2011 with 5 investments, while in other years the number of investments varies from 1 to 4 (Chart 2). All in all, the size of the business angel investments as well as the number is very small, which is pursuant with previously presented theory.

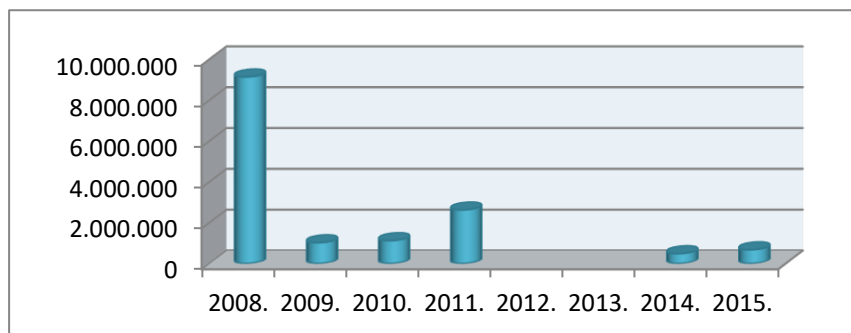


Chart 1: Total business angel investments per year<sup>2</sup> in Croatia (kn) (author according to Cepor (2016, p. 63))

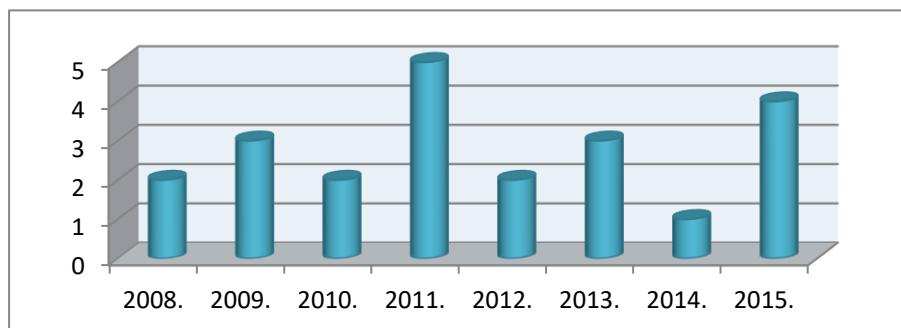


Chart 2: Number of investments per year (author according to Cepor, 2016, p. 63)

### 5.2. Descriptive statistics for early venture capital in Croatia

During the period between 2008 and 2015 in Croatia was total invested near 20.75 million euro of venture capital, which is in average per year just 2.594 million euro. Over the years the level of investment has varied significantly. In 2013 was a peak with the investment of 6.52 million years, while in 2009, 2010 and 2014 the amount of investment is almost insignificant (Chart 3). According to the Invest Europe (2017, p. 41) the stage of investment of Venture Capital can be:

- Seed (“Funding provided before the investee company has started mass production/distribution with the aim to complete research, product definition or product design, also including market tests and creating prototypes. This funding will not be used to start mass production/distribution”),

<sup>2</sup> Data for 2012 and 2013 are not public available.

- Start-up (“Funding provided to companies, once the product or service is fully developed, to start mass production/distribution and to cover initial marketing. Companies may be in the process of being set up or may have been in business for a shorter time, but have not sold their product commercially yet. The destination of the capital would be mostly to cover capital expenditures and initial working capital”),
- Later stage venture (“Financing provided for an operating company, which may or may not be profitable. Later stage venture tends to be financing into companies already backed by VCs. Typically in C or D rounds.”).

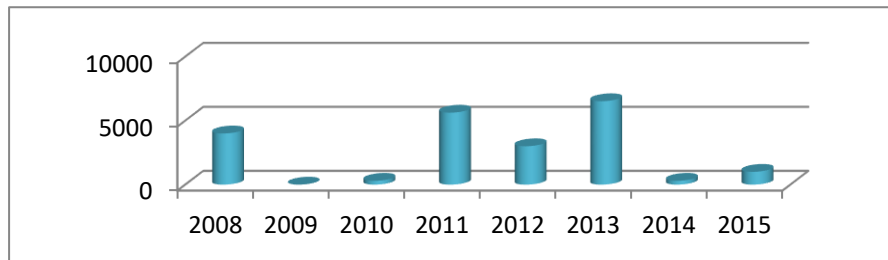


Chart 3: Total VC investments per year ( in 000 €).

Source: authors own calculation based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y, EVCA (2015b, p. 21) and Invest Europe (2017, p. 20)

Apart from total investments, it is also necessary to see the structure of the investment at a particular stage. According to Table 1, during the whole observed period there were no investments in the seed phase, while most were invested in the start-up phase followed by the later-stage venture phase.

Table 1: VC investments by stage (000 €)

	2008	2009	2010	2011	2012	2013	2014	2015
Seed	0	0	0	0	0	0	0	0
Start-up	0	0	300	5625	0	6220	0	3814
Later stage venture	4000	0	0	0	3000	300	300	0

Source: author based on the EVCA/PEREP Analytics for 2014 for Baltics and Ex-Y, EVCA (2015b, p. 21) and Invest Europe (2017, p. 20).

### 5.3. Descriptive statistics for crowdfunding in Croatia

In Croatia in the period from 2014 till 2016 were collected by crowdfunding 10.36 million kuna. The boom was in 2015 with 5.30 million kuna crowdfunding market volume, while in 2016 the market notes a steep decline (Chart 4). During the observed period 157 projects were launched, while only 49 were successful, which makes the performance rate of just 31.2 % (Chart 5). Most of the projects have been launched at foreign crowdfunding platforms, ie Indiegogo and Kickstarter are the dominate platforms for Croatian campaign (Table 2).

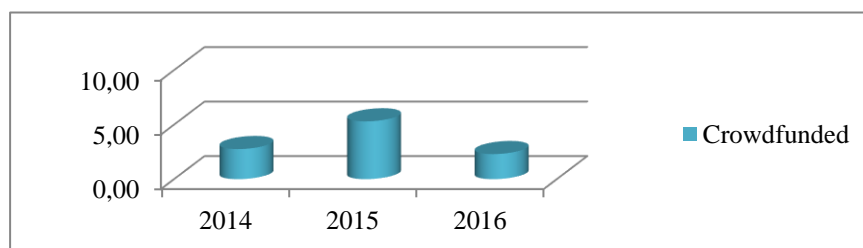


Chart 4: Total amount of crowdfunding in the period 2014 – 2016 (in million kn).

Source: author according to Crowdfunding.hr

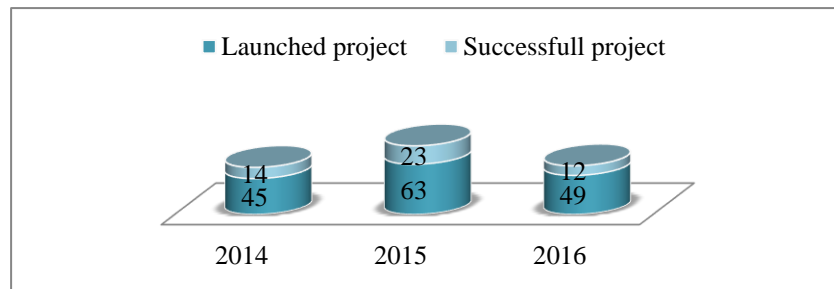


Chart 5: Number of launched project and number of successful projects. Source: author according to Crowdfunding.hr

Table 2: The most used platform for Croatia campaigns the period 2014 – 2016

PLATFORM	2014	2015	2016
Indiegogo	27	47	44
Kickstarter	11	8	3

Source: author according to Crowdfunding.hr

## 6. CONCLUSION

During the last few years the early investment market in Europe is growing. Crowdfunding, as a new way of financing, gets more important. The presence and the growth of the market is very important because of the finance of new, innovative companies and consequently because of the effects on the economic and social system. Therefore, the aim of this paper was to examine and analyze the presence, current state and the importance of the early investment market in Croatia. According to the analyzed data, in the period from 2008 till 2015, in Croatia only 15.5 million kuna were invested from side of business angels. Looking from the aspect of total number of investments the peak was in 2011 with 5 investments, while in other years the number of investments varies from 1 to 4. In the observed period were total invested near 20.75 million euro of venture capital, which is in average per year just 2.594 million euro. Furthermore, during the whole observed period there were no investments in the seed phase, while most were invested in the start-up phase followed by the later-stage venture phase. In the observed period 10.36 million kuna were raised by crowdfunding, 157 projects were launched, 49 successfully. The dominate platforms for Croatian campaign are Indiegogo and Kickstarter. At the end, it can be concluded that all three areas of early investment market, business angels, early venture capital and crowdfunding are present in Croatia. But, despite its presence, the whole market is very small and undeveloped, especially crowdfunding which is almost completely unknown. As future work I see research on the early stage market of CEE countries and comparison with the market in Europe.

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## COURT SETTLEMENT BETWEEN PARTIES IN CONTEMPORARY CRIMINAL PROCEDURAL LAW

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### **ABSTRACT**

*Negotiation between parties in criminal procedure is analyzed here as a mutual way of finalizing criminal procedure. Procedures, which in themselves contain a strong consensual element, are dealt with. These are a part of negotiated justice in a wider sense which is a fundamental link amongst various legal solutions in certain national legislatures. Mentioned is the negotiation among parties within a framework which needs to point out basic differences between Anglo-American and European continental conceptions of that legal institute. Under continental law, these are procedures in which a hearing is not carried out, but rather the court reaches a meritorious decision usually at the preparatory hearing or eventually during investigation or at a special hearing for sentencing criminal law sanctions. This occurs after hearing the parties, and on the basis of files and without presenting particular evidence. It is assumed that there is agreement between parties on the legal qualification of acts and/or punishments. Regarding the application of these procedures, unification does not exist because some procedures can be implemented for minor criminal offences and for others, there is no limit regarding the seriousness of the criminal act. Within consensual types of criminal procedures falls the French procedure of coming to the hearing upon previous admission of guilt, the Italian application of punishment upon request by the parties, expression of guilt and negotiating guilt in Bosnia and Herzegovina and verdicts on the basis of agreement among parties in Croatia. The Swiss summary procedure which represents original agreement solution with reduced public main hearing also belongs to this type of procedure. It seems that the penetration of consensual elements in the area of criminal law is unavoidable together with a warning that this penetration has to be harmonized as best possible with the traditional legal procedural principles and values of continental European Law. Uncritical acceptance of 'contractual' criminal procedural solutions with broad 'bargaining' possibilities appears to be unacceptable regardless of the nature and seriousness of the criminal act.*

**Keywords:** *criminal procedure, consensuality, plea bargaining, negotiated justice, negotiations between parties*

### **1. INTRODUCTION**

The traditional concept of a criminal proceeding is tied to the idea of initiating and leading a criminal proceeding in the interest of the state. This should exclusively serve as an instrument for publicly punishing the perpetrator by applying state repression. In this the private interest of the defendant and the injured party is completely neglected. On the other hand, the second half of the 20th century brings the idea of judicialization and new forms of out- of-court dispute resolution, which have been brought about by a criminal act. Similarly, within the framework of a criminal proceeding, significant changes occur. In this way through the activity of the judicial system, *restorative justice* is attempted which can be achieved by mediation, bargaining etc. The third form of agreement takes place within the criminal system as a substitute for a criminal proceeding through negotiation, agreement, plea bargaining and mediation. The final form entails deviation from certain fundamental criminal proceeding principles, which would destroy its traditional structures. This paper is dedicated to the third form of agreement.

After explaining basic concepts, a comparison of the Anglo-American and European continental concepts of court settlement is given after which follows a brief analysis of court settlement in the national legislatures of France, Italy, Bosnia and Herzegovina, Switzerland and Croatia.

## **2. FUNDAMENTAL CONCEPTS**

There is no single term for mutual agreement in the literature on how to terminate a criminal proceeding. Negotiation, plea bargaining, agreement, negotiated justice, consensuality, benefits, contractual are mentioned for which various authors sometimes have different meanings for the same concept. Here, two concepts will be analyzed. These are negotiated justice and consensuality in criminal proceedings. The concept of negotiated justice can be understood in a wider sense so that it includes various situations in which criminal conflict is the subject of negotiation. That is discussion between the two parties in order to reach agreement. Subjects who are the bearers of some procedural roles such as police, judicial bodies, perpetrators, and victims act, at least, formally as participants in what could be called „the juxtaposition of individual wills“ (Chiavario, 1993, pp. 27-28). Within the concept of consensuality in a criminal proceeding it is possible to include a very wide and motley content so that determining its definition is made very difficult (Krstulović, 2007, p. 3). Moving from the narrowest to the widest scope of that issue we support the definition which seems most appropriate to the main subject of that discussion in this paper. By consensuality, (lat. consensus- assent, harmony, agreement,, bargaining), in a criminal proceeding means that between possible sides, (before commencement of proceedings), or parties (during duration of the criminal proceeding) reaching an agreement on the method of avoiding criminal proceedings (if the proceeding has not been initiated) or on the termination (of the already initiated) criminal proceeding and the legal effect of such an agreement (consent) is regulated by law (Tomašević, 2011, p. 184). The reasons for introducing consensual elements in contemporary legal proceedings are many and varied. In this sense, it is about the gradually dying of and functional changes to classic procedural principles (Esser, 1992, pp. 173-174 and similar.), change to the relation between citizens and government authorities and the whole participation of citizens on the problems of the judiciary. An important role has the demand that, already in the duration of the criminal proceeding, it is of a resocialization nature for the perpetrator of the criminal act and especially in reaching the verdict thereon. This way the legitimate aims of rehabilitation and resocialization for the perpetrator can be achieved regardless of whether the regulated state coercion directed at punishing the perpetrator is applied (Krapac, 2014, p. 93). Maybe this concerns the necessity for the penetration of consensuality, especially negotiated justice in the area of criminal law. It is about a combination of factors of which some are internal and others are external in relation to the area of law and crime. So too is the legitimacy crisis mentioned, as is the internal logic of criminal justice. (Tulkens, 2002, pp. 645-649).

## **3. ANGLOAMERICAN AND EUROPEAN CONTINENTAL CONCEPT OF COURT SETTLEMENT**

Criminal procedure plea bargaining as a legal institute was created under the Anglo-American legal tradition. In England plea bargaining was accepted at the end of the XVIIIth century. The beginning form was reaching agreement between the victim and perpetrator with mediation from justices of the peace (Langbein, 2003, p. 18-20). Historical roots, conditions and prerequisites of contemporary plea bargaining in England lie in the conception of the criminal proceeding as a dispute between opposing parties, market development and defendants becoming involved in hearings the activity of which formalized the procedure and, due to the jury participation, the procedure became lengthy and expensive. All this contributed to the value

of offering concessions to the accused to encourage cooperation with criminal procedure bodies and as returning favors for not contesting charges (Damaška, 2004, pp. 5-8).

Plea bargaining as understood in the modern sense only became court practice at the beginning of the XIXth century. In the USA plea bargaining was accepted in the middle of the XIXth century. The basic reason for this was the significant increase in the number of criminal cases. The resolution of these cases within an acceptable timeframe became practically impossible (Fisher, 2000, p. 857, 897). The fact that the outcome of the procedure could be dubious even when evidence of perpetrators' guilt was strong also contributed to accepting plea bargains as did State Attorneys' stance that complicated and expensive jury adjudication was a senseless waste of time and means when the accused did not deny guilt (Ibidem.). Continental criminal judiciary long resisted the penetration of consensuality in the form of criminal procedure plea bargaining. One of the reasons for this was the belief that criminal procedure was in the public interest and that it was not at the accused's disposal. Apart from that, the doctrinal building of procedural principles was founded on a distinct difference between civil and criminal procedure (Schünemann, 2002). However, the most significant moment was that criminal procedure bodies in continental systems did not feel the expressed need to offer concessions to the accused to achieve speedy and shortened procedures because the need to repeal the main hearing was less than in Anglo-American judicature. It was only after the Second World War and especially after the dissolution of the USSR that the stance on consensual law changed, especially in the fight against organized crime. (Lüderssen, 1995, pp. 329-331). Varying approaches to plea bargaining in contemporary Anglo-American and European Continental law are obvious in certain issues. Plea bargaining in the USA is widely accepted and in procedures for the most serious criminal acts while in continental legislations they are only allowed in minor or medium criminal acts. The subject of negotiation and plea bargaining in Anglo American systems are concessions to the accused who previously accept entering a guilty plea. Such negotiations by the party are known as plea bargaining -bargaining on the plea. This is about accusing oneself (guilty plea, plea of *nollo contendere*), which in itself contains admission of fact and legal conclusion. In European continental judiciaries the subject of negotiation are concessions to the accused who are prepared to confess and, in this way, provide the court incriminating evidence (Damaška, 2004, p. 10). The procedural effect of plea bargaining in Anglo-American procedure are not implementing a jury hearing so that the judge can immediately on the basis of agreement determine punishment. In continental procedure, contracted confession only leads to significantly simplified and shortened hearing. A different scope of plea bargaining of an Anglo-Americans or continental type could be discussed. In the first instance this could be plea bargaining to reduce punishment, prequalification of the charged criminal act and refraining from certain points of the charges. Continental procedures almost in principle allow only guessing related to reducing punishment. It can be said that judges in both systems are not legally forced to accept parties' plea bargaining (Goldstein, 1996, p. 567, 574-575). However, there is a difference in the way it is examined. A continental judge when examining a contracted confession has access to the case file where s/he can check the factual basis of the plea bargain. The Anglo-American judge, given that the case file does not exist, can only use the results of informal and less reliable examinations of procedural participants. The different position of the defendant in the case of eventual unsuccess of the plea bargaining emerges from the legal nature of the foundation of the plea bargain. In the Anglo-American system plea bargains are types of legal contracts (Scott, Stuntz, 1992, p. 1909). Therefore, in the case of the defendant's non-fulfilment of the „ obligations “or the judge's non-acceptance of the plea bargain the defendant may withdraw their act of self-incrimination and the jurors have no knowledge of this. In the continental plea bargain the defendant's withdrawal of confession after non-fulfillment of the prosecutor's “counterpart obligations “or non-compliance of the court with the plea bargain cannot “erase” the content of that confession from the judge's mind.

Even though from this stated fact it seems that the defendant in the Anglo-American system can be surer that the defendant will truly get the contracted concession, it however does not mean that s/he is free of possible pressure by making a plea bargain (Damaška, 2004, pp. 12-13).

#### **4. COURT PLEA BARGAINING IN NATIONAL LEGISLATIONS**

##### **4.1. French procedure of coming to hearing having already admitted guilt**

The procedure of coming to hearing „having already admitted guilt“ (plaider coupable) was introduced in the French Criminal Procedural Law via the Act of 9 March 2004 (De Lamy, 2004) by which in French legislation the widened area of the application of the already existing institute of criminal plea bargaining (composition pénale) as an alternative criminal persecution (Bouloc, 2006, p. 155, 545-547). „Arriving having previously admitted guilt“ (Comparution sur reconnaissance préalable de culpabilité – shortened as plaider coupable) represents a new form of persecution which actually forms an alternative to classic criminal procedure (De Lamy, 2004, p. 1984). The introduction of this institute did not go smoothly and it was introduced according to the model of an analogous legal institute in comparative law (Ibidem, p. 1986-1987). The procedure of pleading guilty (plaider coupable) can only be implemented for offences (délits) for which the main punishment a fine or a sentence of a maximum of five years imprisonment is prescribed. The law expressly excludes the application of that procedure on offences by minors, press offenses, manslaughter, political offenses and offenses for which implementing a special procedure is prescribed. The state attorney may suggest a main or secondary punishment or several prescribed for a certain offense. Herewith, the suggested prison sentence cannot be longer than a year or half the prescribed prison sentence for that offense. Also, it can be a partial or complete conditional sentence or fine. (Bouloc, 2006, p. 787). When choosing a type or measure of punishment the state attorney applies the principle of individualization, taking into account the circumstances of offense commission and the personality of the offender and in the case of a fine the income of the offender. The state attorney initiates the procedure of pleading guilty (plaider coupable) by official duty or at the request of interested parties, that is, the offenders at the request of their lawyers (Ivičević, 2005, p. 205). The procedure commences with the offender's admission of guilt given in front of the state attorney and the statement contents are recorded. Then, the state attorney offers the offender one or more prescribed punishments. The relevant party must have a lawyer of their choice or by official duty who attends all the activities and has access to all files. Before consenting to the proffered criminal law sanction, the offender may consult alone with their lawyer. Also, they may request a ten-day deadline in which they may decide on whether they will accept the proffered punishment/s. (Bouloc, 2006, p. 787). If the relevant party immediately accepts the offered punishment, the procedure of homologation before a high instance court president or delegated judge commences. Consent must be express, free and clear (Saas, 2004, p. 837-838). In the case where the interested party refuses the offer, the state attorney will commence regular proceedings before the official judge or shall ask the judge for information to commence. When the party requests a ten-day deadline to decide on the offer, the state attorney can take them before the authorized judge so that they can be awarded court supervision or detention. In the latter case, the interested party again goes before the state attorney within ten to twenty days starting from the day the judge ordered the measures. (Bouloc, 2006, p. 548, 787). The final act for a successful completion of the procedure of pleading guilty (plaider coupable) is subjecting the treaty of state attorney and interested parties to homologation, which is implemented by the high instance court president or delegated judge. Homologation is „court confirmation to which the law subjects certain acts and which, assuming that the judges implement legality control and often opportunity control, gives the homologation act executive power of court decisions“. Thereto, homologation has more weight than ordinary or “simple

“confirmation (De Lamy, 2004, p. 1988). The judge sets the date for a hearing which the state attorney may not may attend. The judge can only reach a decision after hearing the interested party and their lawyer and checking the reality of the act and legal qualification. The victim can also attend these activities as a civil party (Boulloc, 2006, Ibidem). The judge may either homologize the recommended punishment/s or refuse a request for homologation. However, they are not authorized to determine punishments other than those suggested by the state attorney. Reasons for the judge refusing a request for homologation can be proved by lack of duty by the interested party, tension between fact and the criminal law qualification or if the judge assess nature of the act, position of the victim, or social interest justify implementation of regular criminal proceedings (De Lamy, 2004, p. 1988). The judge issues and publicly reads the positive decision for homologation, the explanation of which contains establishing that the interested party in presence of their lawyer has confessed to the charge and has accepted the suggested punishment and that the punishment is justified given the circumstances of the committed offense and the offenders' personality. The reached decision produces legal effects of a conviction against which an appeal from the convicted or the state attorney is allowed. If the judge rejects homologation or if the interested party rejects the suggestion, the state attorney will commence proceedings before the judge or shall request that the investigation judge commences information.

#### **4.2. Italian application of punishment at party request**

The application of punishment at the request of the parties (applicazione della pena su richiesta delle parti), informally called bargain (patteggiamento); (Cordero, 1993), is a special kind of procedure the specificity of which is agreement (disposition) of the parties before the main hearing where the state attorney and defendant agree on the application of the appropriate punishment. The subject of agreement cannot be criminal prosecution nor the content of the charge. The state attorney cannot refrain from criminal prosecution in regard to certain points of the charge, nor can they requalify certain points of the charge on the basis of negotiation (Aitala, 1998, p. 1109-1160; Daniele, 2001, p. 815-836). The institute of applying punishment at party request experimentally was already introduced in Italian criminal procedure in 1981 for crimes with punishment of deprivation of freedom for no longer than three months. A contemporary form of this procedure was introduced 1988 where the course of time for the area of application was considerably widened (Orlandi, 2004, p. 124). Today two types of bargain exist (De Caro, 2003, p. 21). In the first form of the agreement where imprisonment can be determined from two to five years there are significant advantages for the defendant and can be applied to all criminal acts and all types of perpetrators. In the second form of agreement where the punishment cannot exceed five years, mitigating circumstances cannot be taken into account and there are limits in regard to the type of criminal act and category of perpetrator. Application to criminal acts with prescribed punishment of up to seven and a half years is also possible. The request for application of punishment at party request can be made by the accused or defendant and the state attorney together or by one of the parties with the consent of the other party who has not made the request. Parties can seek application of the punishment of deprivation of liberty (imprisonment), fines and other sanctions reduced up to a third. Thereto, the punishment of deprivation of liberty must not exceed two, that is, five years imprisonment depending on the gravity of the actual criminal act. However, for fines and substitute punishments there is no limit. The request must contain the type and measure of sanction and also may contain other circumstances. The party can also suggest conditional postponement of punishment (Tassi, 2002, p. 200). In regular criminal proceedings the request can be made during the previous proceeding up to the formulation of the final party request at the previous hearing and the final deadline is opening of the main hearing in the first instance procedure (Vigoni, 2003, p. 209-216). The request or consent of the party who has not made the request can be given verbally

during the hearing. The defendant can express their wish directly or via a special procurator or in writing with signature verification. Even though the requests made for application of punishment are not considered as admission of guilt, they do however imply the defendant refraining from disputing the charge, that is, expressing objection to contradictorily accepting punishment. The court can check the voluntariness of the request, that is the defendant's consent. In the case where the request was made by only one party, the other party may later consent to this request. If the state attorney does not agree the defendant's request or is strongly against it, the court may apply the punishment requested by the defendant (Krstulović, 2007, p. 78-80). The procedure for the application of punishment at party request is implemented by provisions on the previous hearing. The judge at the previous examination sets a special hearing at which the request will be decided upon. The court decides at a private meeting basing it on materials collected during previous investigation by the state attorney and perhaps the defender in implementing rights to examining the defense (Vigoni, 2003, p. 168-216; Cordero, 1993, p. 544). Participant position in the procedure for application of punishment at party request differentiates itself from their position in regular criminal proceedings because the parties are authorized to have access to the content of the procedure. Accepting the bargain, the defendant actually relinquishes his/her fundamental procedural right that the court, after contradictorily implemented hearing, decides on his/her criminal liability. Fundamental procedural functions of the state attorney and defender are widened because, together with representing the accusation or defense, they have to assess the justification of the bargaining (Bonini, 1997, pp. 1182-1201). The role of the court in this procedure is relatively more passive and actually boils down to controlling the bargaining between the parties and its ratification. The judge firstly checks the possible existence of reasons for excluding punishability. If the existence of any of these reasons is established, an acquittal is reached regardless of the existence of consent by both parties for application of punishment (Krstulović, 2007, p. 83). The other possibility is rejecting the request due to non-existence of legal conditions or because the court considers the requested punishment inappropriate given the circumstances of the actual case, that is, what is not in accordance with the function of rehabilitating the perpetrator. In this case, the judge determines continuation of the regular criminal procedure. The third possible decision is acceptance of the mutual party request based on the request by one party completed with the consent of the other. That is how things will proceed if on the basis of the displayed statement of fact, a correct legal qualification of the act is held and if the suggested punishment is considered to be appropriate given the extenuating and mitigating circumstances of the actual case as well as if it fulfills rehabilitation aims (Ibidem). If the court agrees with the party's request for application of punishment, it immediately reaches and publishes its verdict by which it hands down the punishment suggested by the parties and states in the judgement that this was reached at the request of the parties. Given that is the accused's goodwill to accept the punishment there is no statement of guilt, nor does admitting to the act, an 'agreed to' verdict is considered to be a special kind of verdict (Peroni, Ranchet, 1994, pp. 126-143; Macchia, 1992, pp. 49-66). Although the accused with a set request for the application for punishment does not deny responsibility, which frees the state attorney from demonstrating burden of proof, an accepted 'agreed to' verdict implies the accused's responsibility for the actual criminal act (Krstulović, 2007, p. 84). It seems an acceptable stance that the accepted 'agreed to' verdict nevertheless contains one, albeit tacit, confirmation of the accused's guilt. Namely, the judge's belief is founded on the investigative case file and the accused's consent allows deviation from the principle of contradictoriness (Carić, 2012, p. 218). When reaching an 'agreed to' verdict the court is tied to the party's request because of which in the verdict a type of measure cannot be sentenced which is different to the one suggested by the parties. The court is then only authorized to accept or reject the request if the sought-after sanction is not believed to be appropriate. In the case of requested conditional conviction, the judge must reject the request if

s/he holds that there are no conditions for the application of that sanction (Krstulović, Ibidem). Although guilt is not mentioned in expressing an ‘agreed to’ verdict, it nevertheless has the effect of a convicting verdict, but with a range of specifics. Of particular importance to the accused are the benefits this verdict brings him/her. The scope of benefits depends on the form of bargain (*patteggiamento*). In both cases the benefit of reducing punishment by up to a third is assured. Also, the verdict has no effect in civil and administrative proceedings apart from disciplinary procedure. An ‘agreed to’ verdict is not registered in criminal evidence. Additional benefits are linked to an ‘agreed to’ verdict in which the sentence of liberation of freedom does not exceed two years alone or together with fines. In this case, the accused cannot be forced to pay criminal procedure costs and secondary fines cannot be applied nor can security measures with the exception of confiscation (Ivičević, 2004, pp. 19-20, 48-50). Also, extinguishing the criminal act occurs which happens within five years when the verdict is related to a criminal act and two years if it is a misdemeanor if additional conditions are achieved. The advantages are excluding the public and reduced costs of defense. An agreed to verdict does not produce legal effects for civil parties. The possibility of quashing a verdict based on party bargaining is limited. The accused cannot appeal against such a verdict because the accused's acceptance of the bargain is considered as relinquishing the right to appeal. The state attorney can appeal if it does not consent to the accused's request or is against the request and only because of the decision on the amount of fine. In other cases, it is possible to file for a cassation appeal. Review of an ‘agreed to’ verdict is not permitted (Lozzi, 1998, p. 1397; Grillo, 2008, p. 3-6).

#### **4.3. Swiss shortened procedure**

With the shortened procedure (*Abgekürztes Verfahren*) the Swiss legislator has actually legalized the trend which already exists in practice, in particular for complex cases of criminal procedures of white collar crime which happens with the help of semi-official agreement. Whether this kind of agreement should be privileged is dubious because it liberates the government from guaranteeing justice and establishing material truths and minorizes the role of judges. Its only advantage are the circumstances that that legal regulation partially mitigates the problem of unequal powers of parties in their activities (Pieth, 2009, p. 196). The accused can request implementation of the shortened procedure from the state attorney when s/he admits the facts crucial for legal qualification of the act and punishment and compensation demands of the injured person. The request can be submitted right up to indictment and can be preceded by „primary informal hearings “which are not legally regulated (Pieth, 2009, p. 197). The shortened procedure is excluded when the state attorney requests a punishment of imprisonment of more than five years. The state attorney decides on initiating the shortened procedure by decision which does not have to be explained and which cannot be disputed. It notifies parties formally of commencement of proceedings and calls on the private prosecutor to state civil claims or claim damages within ten days. The defendant in shortened procedures must have an attorney, but professional help arrives too late for the defendant because it should already be in place during informal negotiations (Carić, 2012, p. 288). The indictment, apart from general data, should contain the planned punishment, directions linked to suspended sentence, recalling the suspended sentence or conditional discharge, decision on civil request of the plaintiff, decision on costs of procedure and damages and the warning to parties that by accepting the indictment they relinquish regular criminal procedure and legal remedy. Showing the state of facts in the indictment must be detailed and comprehensive. The concept of agreement or „deal “carries within itself in an expected sense, exchange of material truth with the agreed „formal “truth (Jositsch, Bischoff, 2007, p. 433). However, the court has a duty to check whether the indictment matches what is in the case file. The verdict is reached on the basis of an indictment which is the result of a deal and becomes *res judicata* which means that without explaining the factual situation no agreement can be reached (Pieth, 2009, p. 198). The state attorney delivers



the indictment to the interested parties which within ten days must be deliberated. The parties must state whether they accept or reject the indictment. Accepting the indictment is irrevocable. The defendant must give consent expressly in writing. If the private prosecutor within ten days does not answer in writing rejecting the indictment the indictment is considered to be accepted. If all parties accept the indictment, the state attorney will submit it together with the case file to the court of first instance. If one party rejects the indictment (e.g. the private prosecutor), the state attorney implements the regular procedure (Goldschmid, Maurer, Sollberger, 2008, p. 354f). The main hearing is implemented before a first instance judge. Even though it is reduced, but a public main hearing, the court must check the agreed arrangement or „deal“. Therefore, the defendant is heard and whether s/he accepts the stated facts and charges by indictment and whether his/her statement in accordance with the contents of the case file. If possible, the court hears the other persons present, but the procedure of giving evidence is not implemented. Therefore, it must be established whether the indictment and statement match the case file whereby a fictive construction cannot be accepted. The court also by its own assessment decides whether the requested and suggested sanctions are appropriate. This type of concept of the main hearing should enable corrections in the state of facts and legal consequences (Pieth, 2009, p. 198). The court assesses whether implementing the shortened procedure is appropriate and justified, whether it matches the indictment of findings at the main hearing and case files and whether the requested sanctions are appropriate. In the verdict, the court states the factual description of the criminal act, legal criminal sanctions, civil demands and indictment in order to reach a decision and briefly explains how the presumptions are fulfilled for shortened procedure. Legal remedy is not completely excluded. One of the parties can appeal against the verdict against on the grounds of two formal reasons: that the defendant did not agree to the indictment and that the verdict does not match the indictment. The court will reject the indictment if it assesses that the conditions for reaching a verdict in a shortened procedure are not fulfilled. In this case, it returns the case file to the state attorney in order to implement regular procedure. Regular procedure must continue in the case of lack of consent, that is, acceptance of parties. In regular proceedings all evidence must be brought forth. Despite numerous complaints (Pieth, 2009, p. 199-200; Schubarth, 2007, p. 532), one needs to conclude that shortened procedure is nevertheless acceptable in criminal proceedings against companies-legal entities (Pieth, 2009, p. 201).

#### **4.4. Pleading guilty and negotiating guilt in Bosnia and Herzegovina**

##### *4.4.1. Pleading*

The institute of pleading, the nature of which is mirrored in providing a formal answer before the court on indictments in the act of indicting, attempts to, before commencement of the main hearing establish whether the defendant accepts the charge or disputes it (Sket, Sijerčić-Čolić, Langusch, 2001, p. 111). Pleading after the judge for the previous hearing has studied the indictment and provided material which the prosecutor has delivered. Having established the existence of justifiable doubt all or some of the indictment points are confirmed. Before the accused pleads, the judge of the previous hearing must also decide about the previous complaints if any (Sijerčić-Čolić, 2008, p. 25-29, 57-67). The accused is asked whether s/he admits or denies guilt in regards to what has been confirmed in the charge. Then a statement of guilt can be given for each criminal act including the gravest. The accused gives his/her plead before the court for the previous hearing in the presence of the prosecutor and defense counsel. This is a special type of statement by the accused which is like a means of his/her defense counsel as an expression of the principle of „equality of weapons “of the parties (Krapac, 2002, p. 309), as is expressing his/her view of the justifiability of the case's charges (Pavišić, 2001, pp. 540-542). The procedure of pleading, depending on the result, can transfer the weight of implementing criminal proceedings from the main hearing to a hearing for sentencing. Before

pleading guilty or not guilty, the judge for previous hearings must make the accused aware of with all the possible consequences of pleading guilty. If s/he does not have an attorney it should be checked if this is possible. If the accused pleads guilty that statement is admission to the charge confirmed by indictment. The judge records this statement and sends this the judge or panel in order to set a hearing date at which the pleading guilty statement will be checked. This hearing commences by establishing whether the accused's statement was given freely, consciously and with understanding. Then, whether all warnings regarding the legal procedural consequences of providing such a statement have been given. That is, whether this means relinquishing the right to trial. The court checks whether the accused's admission is in accordance with the previous collection and presentation of evidence (Sijerčić-Čolić, 2008, pp. 69-70). If all these conditions are fulfilled, the court will accept the accused's statement of guilt given before a judge for previous hearings and records this. At the hearing, only the evidence which are important for expressing the type and measure of actual sanctions are presented (Bubalo, 2008, p. 1144). If the court concludes that the regulated conditions have not been met, it will reject the statement and send the case to the judge or panel for carrying out the main hearing where the statement has no value in the proceeding.

#### *4.4.2. Negotiating guilt*

This procedure consists of party bargaining of guilt, that is about the conditions of admitting guilt between two prosecutors, and suspects, and their defender, which can result in reaching a verdict. Negotiations can be held in the earliest stages of the procedure before trial or at the very trial (Sijerčić-Čolić, 2008, p. 72-73). The procedure can be applied to all criminal acts regardless of their gravity from the least to the most serious. The suggestion for reaching agreement can be initiated by both the prosecutor and suspect that is the defendant and his/her attorney. The subject of negotiation are the conditions for admitting guilt the suspect/accused is charged. The subject of negotiation cannot be the prosecutor refraining from prosecution for some criminal acts nor can the prosecutor offer a more lenient legal qualification of an act which the existing evidence does not confirm. The negotiation conditions relate to the type and extent of legal criminal sanction which is expressed to suspect/accused (Sijerčić-Čolić et al., 2005, p. 622). The prosecutor can suggest sentencing of punishment under the law of prescribed minimum punishment for that act, that is the more lenient legal criminal sanction. The procedure of negotiation of guilt can be implemented during the entire criminal procedure, that is during investigation, the stage of prosecuting, at the main hearing and even at the hearing before the appellate panel. Negotiations can already commence at the moment the prosecutor considers that s/he has enough evidence on the suspect's guilt. If the negotiations take place during the investigation, that is before indictment then party agreement on admission of guilt in written form will be made up later and together with the indictment is delivered to the judge of the previous hearing and hearing judge, that is panel. (Sijerčić-Čolić, 2003, p. 79). After confirming the indictment, agreement on admission of guilt is delivered to the judge of the previous hearing who expresses a legal criminal sanction for the suggested agreement. After delivering the case in order to set the main hearing date, the judge, that is the panel, decides on the agreement. The agreement on admission of guilt must be made in writing and is submitted to the court for consideration and decision. The agreement is made up of statement of admission of guilt for the criminal act and the legal criminal sanction which is the result of the agreement between accusation and the defense. When examining the agreement the court must check whether the following conditions are met: was the agreement made freely and willingly, consciously and with understanding; was the accused aware of the legal consequences of such an agreement; is there enough evidence of guilt; did the suspect understand that s/he relinquishes his/her right to trial in court and that s/he is sentenced to the legal criminal sanction at the hearing for sentencing; did the accused understand that s/he is unable to appeal (Sijerčić-

Čolić, 2003, p. 80-81). If the court accepts the agreement, it records the statement and at the sentencing hearing reaches a verdict that declaring the person guilty and pronounces the legal criminal sanction. If the court rejects the statement of admission of guilt, a special record is made and the criminal case is 'returned' for regular criminal procedure.

#### **4.5. Verdict on the basis of party agreement in Croatia**

Verdict on the basis of party agreement was introduced into Croatian procedural law in 2008. It was preceded by a verdict at party request during investigation introduced in 2002 (Mrčela, 2002, p. 360-370). Reaching this verdict is possible for all cases regardless of the severity of the criminal act which can be disputable (Tomičić, Novokmet, 2012, p. 179-180). The exception are criminal acts against life and person and against sexual freedom which the state attorney must gain the consent of the victims for agreed bargaining (Ivičević-Karas, Puljić, 2013, p. 844; Cambj, 2013, pp. 675-676). The defendant can make a statement that s/he feels guilty on all or on only on some counts of the indictment. Also, s/he can only admit guilt, but does not need to be prepared to agree on the sanction, that is agreement on the sanction does not need to be achieved. In this case, the indictment panel will confirm the indictment and send the case file to the court in order for the hearing to be determined. The other possibility is agreement between the accused and the state attorney on the guilt and the sanction. The procedure for negotiation on the conditions of admitting guilt and agreement over the sanction represents a bargain between the state attorney and the accused, where parties first agree on mutual facts and considerations (Krapac, 2014, p. 95). During negotiations, the accused must have an attorney. The subject of the bargaining can only be the conditions of the accused's admission of guilt and a more lenient form and reduced measure of legal criminal sanction which can be pronounced (Krapac, 2008, p. 373). The possibility of negotiations on the legal qualification and abstaining from prosecution is excluded (Tomičić, Novokmet, 2012, p. 179). If agreement is reached between the state attorney and the accused, the state attorney formulates an agreement which serves as a foundation for a statement for reaching verdict on the basis of agreement between parties. The state attorney, accused and attorney sign this statement and together submit it as a written request to the indictment panel immediately after the meeting is opened or during the meeting (Pavišić, 2011, p. 691). The statement must contain: description of the criminal act which is the subject of the accusation; the accused's statement on admission of guilt for that criminal act; agreement on the type and measure of the punishment or other sanctions or measures; agreement on the costs of the criminal procedure; the accused's statement on the submitted legal property request; and the signature of the parties and attorney. Only such a statement forms the basis for reaching a verdict on the basis of party agreement by which the following criminal law sanctions can be pronounced: fines and imprisonment, court warning, suspended sentence, partial suspended sentence, certain obligations, protective supervision, confiscation of subject, security measures and confiscation of property gain acquired by criminal act. The state attorney notifies the victim or injured party on the signing of the agreement. The indicting panel can reach a verdict on the basis of party agreement only if the party delivers a written statement for reaching such a verdict. After receiving such a statement, the panel must confirm that the party consents in relation the subject of the statement and register that consent in the records. Then, the panel decides on the confirmation of the indictment which must be preceded by accepting the statement as an obligatory condition for that. (Ivičević Karas, Puljić, 2003, p. 839). After comprehensive examination of the indictment if the existence of one of the reasons is established, the panel must stop the criminal proceeding, that is, rebut the indictment or return the indictment to the prosecutor with explanation of the reason or activities which s/he has omitted to implement. If the statement is accepted, the panel reaches a verdict by which punishment or some other legal criminal sanction resulting from the agreement is pronounced to the accused.

The indicting panel will not accept the statement if, given the circumstances, its acceptance is not pursuant to the measure of punishment as prescribed by law or the agreement otherwise is not legal. In that case, the indicting panel will, by written judgement, reject the statement whereby an appeal is not allowed. The indictment panel is obliged to evaluate both the legality and the level of punishment. The court is not authorized to enter into assessing the essence of the agreement linked to the state of facts. Rather, the role of the court boils down to checking the bargain and its ratification. The role of courts can be assessed as objective, but to some extent marginalized (Damaška, 2004, p. 15). Up to reaching the verdict, the party can refrain from the submitted agreement suggestion. The indicting panel reaches the verdict based on party agreement in the accusation stage. A special type of conviction is in question here by which the accused is pronounced guilty. That verdict immediately is published and it is made in writing and delivered to the parties within eight days of notification. The verdict consists of an introduction, pronouncement and short explanation which includes the statement for reaching the verdict on the basis of party agreement. Only those legal criminal sanctions and measures that the parties have suggested can be pronounced (Krapac, 2014, pp. 291-292). The verdict on the basis of agreement between parties cannot be rebutted by an appeal because of a criminal law sanction, taking away property gain, costs of the criminal procedure and legal property request and because of erroneous or incomplete establishment of the factual state. It can only be rebutted due to significant breach of criminal procedure provisions and because of breach of criminal law.

## 5. CONCLUSION

The basic link of various legal solutions of plea bargaining of parties in criminal proceedings in certain national legislations is a strong consensual element. It concerns the agreement between state attorney and defendant on giving the defendant's admission of guilt and pronouncing more lenient punishments as an answer to the cooperativeness of the defendant. The initiative for such an agreement can come from one or both parties. Prequalification of the actual criminal act is not possible for a minor act as is refraining from criminal prosecution on some counts of the indictment also not possible. Instead of a contradictory public hearing, a shortened non-contradictory hearing is implemented, that is a preparatory hearing for pronouncing legal criminal sanctions. The role of the judge goes from its own type of ratification of party agreement to implementing the simplified hearing. However, in principle it is prescribed that the judge checks the conditions under which the admission was given and whether the admission is in accordance with other implemented evidence. There is no uniformity regarding the area of application of these procedures because some procedures can only be carried out for minor criminal acts and for others there is no limit given the gravity of the criminal act. It seems that the penetration of consensual elements in the area of criminal law is unavoidable with the warning that that it is necessary to attempt as best possible to harmonize that penetration with traditional procedural principles and values of continental European law. To non-critically accept „what has been contracted “in resolving a criminal proceeding with wide possibilities for „haggling “regardless of the nature and gravity of the criminal act is unacceptable.

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# DATA RETENTION IN THE FIELD OF TELECOMMUNICATIONS – PRIVACY AND ELECTRONIC COMMUNICATIONS DIRECTIVE IN THE RECENT CJEU JURISPRUDENCE AND ITS IMPACT ON FIGHTING ECONOMIC CRIME

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## **ABSTRACT**

*Data retention law is of great significance in fighting crime. Each communication via electronic devices leaves certain traces; most important of them are traffic and location data. These data can be used by law enforcement agencies to identify suspects of the crime, or to check credibility of statements of defendants of witnesses in criminal proceedings, or, generally, gather evidence for court proceedings. Legal regulation of this area of data retention in European Union, where interest of fighting crime and public safety confronts with the right to privacy and the right to protection of personal data, is one of the most debated topics, and therefore it is no wonder that Court of Justice of European Union (CJEU) in its jurisprudence met several very important decisions, among others Digital Rights Ireland & Seitlinger and Ors (joined cases C-293/12 and C-594/12) in 2014. and Tele2/Watson (joined cases C-203/15 and C-698/15) in 2016. These cases deal with application of certain important provisions of Privacy and Electronic Communications Directive<sup>1</sup> and some other EU Directives. In the last judgment in Tele2/Watson case, the Grand Chamber of European Court of Justice determined that Article 15(1) of Directive 2002/58, as amended by Directive 2009/136, read in the light of Articles 7, 8 and 11 and Article 52(1) of the Charter of Fundamental Rights, must be interpreted as precluding national legislation governing the protection and security of traffic and location data and, in particular, access of the competent national authorities to the retained data, where the objective pursued by that access, in the context of fighting crime, is not restricted solely to fighting serious crime, where access is not subject to prior review by a court or an independent administrative authority, and where there is no requirement that the data concerned should be retained within the European Union. Although the aforementioned judgments of CJEU set some mandatory requirements, the national legislators still have difficult task regulating this sensitive legal area.*

**Keywords:** *right to respect for private life, protection of personal data, data retention, traffic data, location data, European Union, Court of Justice of European Union*

## **1. INTRODUCTION**

Data retention law is of great significance in fighting crime. Each communication via electronic devices leaves certain traces; most important of them are traffic and location data. These data can be used by law enforcement agencies, or national security bodies to identify suspects of the crime, or to check credibility of statements of defendants of witnesses in criminal proceedings, or, generally, gather evidence for court proceedings. More types of this data, retained in longer period of time, can reveal a lot about private life of individual, his habits, social circle, etc. Legal regulation of this area of data retention in European Union, where interest of fighting crime and public safety confronts with the right to privacy and the right to protection of personal data, is one of the most debated topics, and therefore it is no wonder that

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<sup>1</sup> Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) Official Journal L 201 , 31/07/2002 P. 0037 - 0047

Court of Justice of European Union (CJEU) in its jurisprudence met several very important decisions, among others *Digital Rights Ireland & Seitlinger* and *Ors* (joined cases C-293/12 and C-594/12) in 2014. and *Tele2/Watson* (joined cases C-203/15 and C-698/15) in 2016. These cases deal with application of certain important provisions of Privacy and Electronic Communications Directive<sup>2</sup> and some other EU Directives.

## **2. EUROPEAN UNION LEGISLATION**

### **2.1. Charter of Fundamental Rights of the European Union**

Respect for private and family life is guaranteed in art. 7. of Charter of Fundamental Rights of the European Union (further: Charter) and many other human rights documents. However, neither of these documents provides a definition of privacy, mostly because defining privacy is quite difficult task (Tzanou, M. (2017), p. 8). The provision of art. 7. Contains, beside the right to respect for private and family life, right to respect home and communications. Unlike European Convention on Human rights, one very important aspect of the right to respect for private life is in Charter considered as separate basic human right. It is right to protection of personal data (art. 8).<sup>3</sup> The Charter is the first supra-national document recognizing the right to protection of personal data separately from the right to respect for private life (González Fuster, G. (2014) p. 199). The Charter in art. 8. contains not only general provisions on the right to the protection of personal data, but also obligation that such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Regarding the right of access to retained data, the Charter states that everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified and that compliance with these rules shall be subject to control by an independent authority. Although art. 7 and art. 8, as described above, at the first glance are the only one that we should consider when discussing Charter provisions in this aspect, one more very important right should also be mentioned. Art. 11. guarantees the right to freedom of expression, that includes freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers. Every time when we consider actual scope of some right or principle from Charter, it is inevitable to interpret art. 52. of Charter. According to this provisions of Charter, any limitation on the exercise of the rights and freedoms recognised by the Charter must be provided for by law and respect the essence of those rights and freedoms. Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the European Union or the need to protect the rights and freedoms of others.

### **2.2. Privacy and Electronic Communications Directive**

Privacy and Electronic Communications Directive, known as ePrivacy Directive 2002, is the most important source of EU law dealing with protection of privacy of electronic communications of EU citizens. The scope and aim of Directive is to harmonize the provisions of the Member States required to ensure an equivalent level of protection of fundamental rights and freedoms, and in particular the right to privacy, with respect to the processing of personal data in the electronic communication sector and to ensure the free movement of such data and

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<sup>2</sup> Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) Official Journal L 201 , 31/07/2002 P. 0037 - 0047

<sup>3</sup> It is understandable regarding the fact that European Convention on Human Rights was drafted in 1950, and Charter of Fundamental Rights of the European Union half of century later, considering the development of international law on human rights in the second half of 20th century. Busser analyzed the judicature of European Court of Human Rights and claims that a clear link between the right to privacy and the right to protection of personal data is finally made in 2000 (*Amman v. Switzerland*, EctHR, § 65). Busser, E. D. (2009), p. 48-49.



of electronic communication equipment and services in the Community (art 1. par. 1.). This Directive was amended by Directive 2009/136/EC of the European Parliament and of the Council of 25 November 2009. Directive guarantees several very important rights. Confidentiality of the communications, (art. 5) is one of most important ones for the protection of personal privacy. In this article the Directive creates obligation for member states to ensure the confidentiality of communications and the related traffic data by means of a public communications network and publicly available electronic communications services, through national legislation. In particular, they shall prohibit listening, tapping, storage or other kinds of interception or surveillance of communications and the related traffic data by persons other than users, without the consent of the users concerned, except when legally authorised to do so in accordance with Article 15(1) of this Directive. Important provisions of ePrivacy directive can further be found in art. 6. (traffic data), art. 8. (presentation and restriction of calling and connected line identification) and art. 9. (location data). The most important article, regarding the collecting of evidence for the purpose of criminal proceedings, is art. 15. par. 1 which provides that member states may adopt legislative measures to restrict the scope of the rights and obligations provided for in Article 5, Article 6, Article 8(1), (2), (3) and (4), and Article 9 of this Directive when such restriction constitutes a necessary, appropriate and proportionate measure within a democratic society to safeguard national security (i.e. State security), defence, public security, and the prevention, investigation, detection and prosecution of criminal offences or of unauthorised use of the electronic communication system as referred to in Article 13(1) of Directive 95/46/EC.

### **2.3. Data Retention Directive<sup>4</sup>**

In 2006. European Union brought Data Retention Directive, which imposed general obligation to member states to store citizens' telecommunications data to longer periods of time (from 6 to 24 months - articles 3 and 6) It is common assumption that it was at least partially consequence of terroristic attacks in Madrid and London in 2004. and 2005. Approach to stored data for police, criminal prosecution and security agencies was subject to previous judicial approval. This Directive was declared invalid by Court of European Union in the judgment in case Digital Rights Ireland.<sup>5</sup> Beside Charter and above mentioned Directives, there are other very important sources of European Union Law regulating conditions of usage of retained data for the purpose of fighting crime, such as „Law Enforcement Directive“ 2016/680<sup>6</sup> and Europol Regulation 2016,<sup>7</sup> but we will not elaborate it here because it is not focus of the article.

## **3. JUDGMENTS OF THE COURT OF THE EUROPEAN UNION**

Court of the European Union dealt with the content of aforementioned directives in several cases, most important of them being Digital Rights Ireland and Seitlinger and others in 2014. and Tele2/Watson in 2016.

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<sup>4</sup> Directive 2006/24/EC of the European Parliament and of the Council of 15 March 2006 on the retention of data generated or processed in connection with the provision of publicly available electronic communications services or of public communications networks and amending Directive 2002/58/EC

<sup>5</sup> See *infra* 3.1.

<sup>6</sup> 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.

<sup>7</sup> 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 Regulation) [2016] OJ L 135/53. This Regulation entered into force on the 1 May 2017, and it brings very important changes – most important of them regarding data protection is that, as Coudert emphasizes, the principle of purpose limitation is not implemented anymore through the so-called 'silo-based approach' - the focus of the Regulation is not on databases but on data processing operations. Coudert, F. (2017), The Europol Regulation and Purpose Limitation: From the Silo Based Approach to What Exactly, 3 Eur. Data Prot. L. Rev. 313 p. 313.

### 3.1. Digital Rights Ireland and Seitlinger and Others

In its judgment in the case *Digital Rights Ireland and Seitlinger and others*<sup>8</sup> the Court of Justice of the European Union (henceforth: CJEU or the Court) declared the Data Retention Directive to be invalid. CJEU stated that the obligation imposed by Articles 3 and 6 of Directive 2006/24 on providers of publicly available electronic communications services or of public communications networks to retain, for a certain period, data relating to a person's private life and to his communications, such as those referred to in Article 5 of the directive, constitutes in itself an interference with the rights guaranteed by Article 7 of the Charter of fundamental human rights of the EU. (par. 34). CJEU pointed that Directive 2006/24 constitutes an interference with the fundamental right to the protection of personal data guaranteed by Article 8 of the Charter because it provides for the processing of personal data. It concluded that such interference with the fundamental rights laid down in Articles 7 and 8 of the Charter must be considered to be particularly serious. Furthermore, the fact that data are retained and subsequently used without the subscriber or registered user being informed is likely to generate in the minds of the persons concerned the feeling that their private lives are the subject of constant surveillance (par. 36. -37.). CJEU then provided interpretation of above mentioned provisions of art. 52. par. 1. of the Charter. Regarding the subject of this article, and possibility of data retention for the purpose of fighting crime, par. 42. must be cited: „It is apparent from the case-law of the Court that the fight against international terrorism in order to maintain international peace and security constitutes an objective of general interest... The same is true of the fight against serious crime in order to ensure public security... Furthermore, it should be noted, in this respect, that Article 6 of the Charter lays down the right of any person not only to liberty, but also to security.“ Regarding the question of whether the retention of data is appropriate for attaining the objective pursued by Directive 2006/24, CJEU wrote that it must be held that, having regard to the growing importance of means of electronic communication, data which must be retained pursuant to that Directive allow the national authorities which are competent for criminal prosecutions to have additional opportunities to shed light on serious crime and, in this respect, they are therefore a valuable tool for criminal investigations. Consequently, the retention of such data may be considered to be appropriate for attaining the objective pursued by that directive (par. 49). As regards the necessity for the retention of data required by Directive 2006/24, CJEU admitted that it must be held that the fight against serious crime, in particular against organised crime and terrorism, is indeed of the utmost importance in order to ensure public security and its effectiveness may depend to a great extent on the use of modern investigation techniques. However, such an objective of general interest, however fundamental it may be, does not, in itself, justify a retention measure such as that established by Directive 2006/24 being considered to be necessary for the purpose of that fight. So far as concerns the right to respect for private life, the protection of that fundamental right requires, according to the Court's settled case-law, in any event, that derogations and limitations in relation to the protection of personal data must apply only in so far as is strictly necessary (para. 51.-52.). *Digital Rights Ireland* judgment had great impact, not only in European Union.<sup>9</sup>

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<sup>8</sup> *Digital Rights Ireland Ltd v Minister for Communications, Marine and Natural Resources, Minister for Justice, Equality and Law Reform, Commissioner of the Garda Síochána, Ireland, The Attorney General, intervener: Irish Human Rights Commission (C-293/12), and Kärntner Landesregierung Michael Seitlinger, Christof Tschohl and others (C-594/12)*, (Judgment in joined cases C - 293/12 and C - 594/12).

<sup>9</sup> See. e.g. Vainio, N., Miettinen, S., (2015) Telecommunications data retention after *Digital Rights Ireland*: legislative and judicial reactions in the Member States, *International Journal of Law and Information Technology*, Volume 23, Issue 3, September 2015, (p. 290), Granger, M. - P., K. Irion. K. (2014) The Court of Justice and the Data Retention Directive in *Digital Rights Ireland*: telling off the EU legislator and teaching a lesson in privacy and data protection, *European Law Review* 39, no. 4 (p. 835) and for influence outside Europe: Fabbrini, F. (2015) Human Rights in the Digital Age: The European Court of Justice Ruling in the Data Retention Case and Its Lessons for Privacy and Surveillance in the United States, 28 *Harv. Hum. Rts. J.* (p. 65). and Park, H.-Y. (2015) The Invalidation of the EU Data Retention Directive and its Implication for Korea, *Dongguk Law Review*, vol. 6. (p. 55.).

Although it left some very important question unresolved and unclear (see e.g. Opinion of Advocate General Saugmandsgaard Øe in Joined Cases C-203/15 and C 698/15, pr. 189.), it influenced numerous changes of national legislations, and led to action of one Swedish provider, Tele2, which caused the CJEU judgment in Tele2/Watson case we will discuss now.

### 3.2. Tele2/Watson

In Tele2/Watson case,<sup>10</sup> CJEU had to decide if Swedish and UK legislation were compliant to EU law, namely compliant to ePrivacy Directive 2002 as amended by Directive 2009/136/EC, read in the light of Articles 7 and 8 and Article 52(1) of the Charter of Fundamental Rights of the European Union. Swedish and UK law contained provisions that imposed data retention for certain period of time, more precisely imposed obligation for electronic communication providers to retain traffic and location data. Given the seriousness of the interference in the fundamental rights concerned represented by national legislation which, for the purpose of fighting crime, provides for the retention of traffic and location data, CJEU emphasized that only the objective of fighting serious crime is capable of justifying such a measure (par. 102.).<sup>11</sup> Further, while the effectiveness of the fight against serious crime, in particular organized crime and terrorism, may depend to a great extent on the use of modern investigation techniques, such an objective of general interest, however fundamental it may be, cannot in itself justify that national legislation providing for the general and indiscriminate retention of all traffic and location data should be considered to be necessary for the purposes of that fight (par. 103.). It is further explained why is such general data retention unacceptable; CJEU stated that national legislation such as that at issue in the main proceedings, which covers, in a generalised manner, all subscribers and registered users and all means of electronic communication as well as all traffic data, provides for no differentiation, limitation or exception according to the objective pursued. It is comprehensive in that it affects all persons using electronic communication services, even though those persons are not, even indirectly, in a situation that is liable to give rise to criminal proceedings. It therefore applies even to persons for whom there is no evidence capable of suggesting that their conduct might have a link, even an indirect or remote one, with serious criminal offences (par. 105).<sup>12</sup> The problem with such legislation is that it does not require there to be any relationship between the data which must be retained and a threat to public security. In particular, it is not restricted to retention in relation to (i) data pertaining to a particular time period and/or geographical area and/or a group of persons likely to be involved, in one way or another, in a serious crime, or (ii) persons who could, for other reasons, contribute, through their data being retained, to fighting crime. Therefore, such national legislation exceeds the limits of what is strictly necessary and cannot be considered to be justified, within a democratic society (para 106.-107). However, Article 15(1) of Directive 2002/58, read in the light of Articles 7, 8 and 11 and Article 52(1) of the Charter, does not prevent a Member State from adopting legislation permitting, as a preventive measure, the targeted retention of traffic and location data, for the purpose of fighting serious crime, provided that the retention of data is limited with respect to four main criteria, or prerequisites, that CJEU built.

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<sup>10</sup> Tele2 Sverige AB (C 203/15) v Post- och telestyrelsen, and Secretary of State for the Home Department (C 698/15) v Tom Watson, Peter Brice, Geoffrey Lewis, joined case, judgement of 21 December 2016.

<sup>11</sup> The Court accepted the opinion of Advocate General *Saugmandsgaard Øe* regarding the difference between ordinary and serious crime when it comes to data retention. Calomme (in article written before court judgement in this case, analysing Advocate General's opinion, warned that „if the Court decides to follow the Advocate General, it should also specify whether 'serious crime' must be given an autonomous meaning or whether it should follow the meaning given in national law.“ Calomme, C. (2016) Strict Safeguards to Restrict General Data Retention Obligations Imposed by the Member States, 2 Eur. Data Prot. L. Rev. 590 p. 594.

<sup>12</sup> Additional problem is professional secrecy – the Court wrote that such general data retention obligation does not provide for any exception, and consequently it applies even to persons whose communications are subject, according to rules of national law, to the obligation of professional secrecy.

Eventual data retention hence must be limited to what is strictly necessary with respect to 1) with respect to the categories of data to be retained, 2) the means of communication affected, 3) the persons concerned and 4) the retention period adopted. CJEU imposed obligation to member states - in order to satisfy the requirements, the national legislators must, first, lay down clear and precise rules governing the scope and application of such a data retention measure and imposing minimum safeguards, so that the persons whose data has been retained have sufficient guarantees of the effective protection of their personal data against the risk of misuse (par. 109). It is also very important to emphasize that CJEU confirmed (phrase: „it is essential“ was used) the principle that access of the competent national authorities to retained data should, as a general rule, except in cases of validly established urgency, be subject to a prior review carried out either by a court or by an independent administrative body, and that the decision of that court or body should be made following a reasoned request by those authorities submitted, inter alia, within the framework of procedures for the prevention, detection or prosecution of crime. Additional very important parts of Tele2/Watson judgment that, in my opinion, should be emphasized are 1) the obligation of the competent national authorities to whom access to the retained data has been granted to notify the persons affected, under the applicable national procedures, as soon as that notification is no longer liable to jeopardise the investigations being undertaken by those authorities, 2) the right of persons affected to a legal remedy, expressly provided for in Article 15(2) of Directive 2002/58, read together with Article 22 of Directive 95/46, where their rights have been infringed, and 3) the data concerned should be retained within the European Union (ruling that is very important regarding international police and judicial cooperation in criminal matters). To summarize, CJEU ruled that Article 15(1) of ePrivacy Directive 2002, as amended by Directive 2009/136/EC of the European Parliament and of the Council of 25 November 2009, read in the light of Articles 7, 8 and 11 and Article 52(1) of the Charter of Fundamental Rights of the European Union, must be interpreted as precluding national legislation which, for the purpose of fighting crime, provides for general and indiscriminate retention of all traffic and location data of all subscribers and registered users relating to all means of electronic communication. Therefore, that provisions must be interpreted as precluding national legislation governing the protection and security of traffic and location data and, in particular, access of the competent national authorities to the retained data, where the objective pursued by that access, in the context of fighting crime, is not restricted solely to fighting serious crime, where access is not subject to prior review by a court or an independent administrative authority, and where there is no requirement that the data concerned should be retained within the European Union (par. 134.)

#### 4. CONCLUSION

Approach to retained traffic and location data can certainly be very useful tool for finding perpetrators and collecting evidences in fighting crime. Organized economic crime, in some cases, regarding the amount of money that is dealt with, or the size of the company involved, can have devastating effect not only for individuals, but also for large companies and in some cases even for whole economy of some smaller countries.<sup>13</sup> Therefore in such cases it should without doubt be considered as „serious crime“ in terms of CJEU judgments.<sup>14</sup>

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<sup>13</sup> There are situations where some large companies or concerns represent significant part of nation's economy (quantified in % of GDP), and therefore criminal activity in connection with such large entities can have negative effect on whole country.

<sup>14</sup> CJEU judgement in Taricco case of 5. December 2017. is perfect illustration of the significance of serious organized economic crime, in this case VAT fraud. CJEU ruled that „Article 325(1) and (2) TFEU must be interpreted as requiring the national court, in criminal proceedings for infringements relating to value added tax, to disapply national provisions on limitation, forming part of national substantive law, which prevent the application of effective and deterrent criminal penalties in a significant number of cases of serious fraud affecting the financial interests of the European Union, or which lay down shorter limitation periods for cases of serious fraud affecting those interests than for those affecting the financial interests of the Member State concerned, unless that disapplication entails a breach of the principle that offences and penalties must be

After CJEU 2014. judgment *Digital Rights Ireland* declared Data Retention Directive invalid, situation in Europe could be described as heterogeneous.<sup>15</sup> *Tele2/Watson* judgment has clarified some confusion around the proper interpretation of the *Digital Rights* case - specifically, it has clarified confusion concerning whether EU law allows for the generalised retention of personal data and determined extended mandatory requirements or measures that allow for the retention of personal data and its accessing by public bodies (Mbogh, R., W. (2017) p. 281-282). Yet, some European countries still have „old“ rules which impose general and indiscriminate retention of traffic and location data, what must be considered as breach of basic human rights guaranteed in the Charter. While Constitutional and other courts in some countries declared such provisions contrary to constitutions, some other countries still wait for common European frame and legislation to be adopted into national legislation systems.<sup>16</sup> But, it seems that European Union is not willing to take the lead in regulating tasks this time (Munir, A., B., Yasin, S., H., M., Bakar, S., S., A. (2017), p. 83). As stated in *Tele2/Watson* case judgment, national legislators must, first, lay down clear and precise rules governing the scope and application of such a data retention measure and imposing minimum safeguards, so that the persons whose data has been retained have sufficient guarantees of the effective protection of their personal data against the risk of misuse. Therefore, it is slippery ground for national regulators, which have to be very careful and have to take into account many different elements, from the interests of national security and fight against terrorism and other serious crime to the right to private life and right to protection of personal data.

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defined by law because of the lack of precision of the applicable law or because of the retroactive application of legislation imposing conditions of criminal liability stricter than those in force at the time the infringement was committed.

Since significant part of economic crime of larger scale has some international element within, exchange of information between European countries is crucial and inevitable element of investigation in such cases. While cooperation between EU members is mostly regulated and therefore faces less problems, cooperation with other significant partners must also be considered and developed while simultaneously maintaining data protection principles of different legal systems. Especially significant in this aspect is cooperation between EU and United States of America, because of number of big companies and concerns that do business in both continents. See: Busser, E. D. (2009) *Data Protection in EU and US Criminal Cooperation: A Substantive Law Approach to the EU Internal and Transatlantic Cooperation in Criminal Matters between Judicial and Law Enforcement Authorities*, Maklu Publishers.

<sup>15</sup> Very important and useful are also judgments of European Court of Human Rights regarding the question if retention of certain data or DNA samples is disproportionate interference with the right to private life from art. 8. of European Convention of Human Rights. See: Kouvakas, I., *The Watson Case: Another Missed Opportunity for Stricto Sensu Proportionality*, 2 *Cambridge L. Rev.* 173 (2017), p. 178., where author claims the reasoning of the Strasbourg Court in the case „*Adarper v UK*“ was extensively followed by the Grand Chamber in *Digital Rights Ireland*.

<sup>16</sup> See e.g. for Germany: Etteldorf, C., *Higher Administrative Court of Northrhine Westphalia Declares German Data Retention Law Violates EU Law*, 3 *Eur. Data Prot. L. Rev.* 394 (2017), and her comment on problems in period between 2010, when German Constitutional Court had declared unconstitutional German law transposing the Data Retention Directive and 2014. *Digital Ireland* CJEU judgement.

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## MEDIATION IN BUILDING MANAGEMENT – AUSTRIAN AND CROATIAN PRACTICE

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### ABSTRACT

*„Condominium est mater rixarium.“ Ancient Romans have known that there is no co-ownership without obstacles, especially when real property is in question. There is a lot of ways to solve co-owners' dispute, but just one can offer a win-win situation. Mediation is one of the most successful ways of resolving disputes today. The most important advantage of mediation is parties' participation in the organization of future relationship. On the other hand, in the modern world, people like to have somebody to manage their property. Building management has been increased these days, but expectations have been increased together with the market. Good building manager has to balance between co-owners, their individual interests, and collective interest, usually, it includes resolving disputes and being a mediator in a community. Austria is one of the most successful countries when mediation is in question. They have the full system of education of mediators, as well as very good system offered to their citizens when it comes to the real property dispute. Local authorities provide different types of resolving disputes, including mediation and arbitration in some cases. Croatian system meets advantages of mediation on daily basis, but it could be said that we are at the start of the journey. At some point, Croatian building managers will have to consider how to resolve co-owners' disputes cheaper, faster and more effective. Are we still at the ancient maxima or we are ready to try some new ways which lead us to the win-win situation, even in a case of a condominium?*

**Keywords:** *building management, co-owners, mediation*

### 1. INTRODUCTION

Ancient Romans have laid the foundation of the system of condominium for civil law legal systems. Like we borrowed the concept of condominium from ancient Rome, we have also borrowed the concept of mediation from ancient Greece where mediators, so-called *proxenatas* have been empowered for mediation, with the exception of family mediation (Knol Radoja, 2015, p. 111). Today's lifestyle could be very stressful, especially having in mind number of relationships and interactions we all have on daily basis. This complexity demands faster and cheaper way of resolving our disputes. Mediation is one of the alternative ways of resolving disputes (Alternative Dispute Resolution-ADR includes also arbitration, conciliation, mini-trial, early neutral evaluation) (Šimac, 2006, p. 613) in which parties achieve settlement of their dispute on a mutual satisfaction. Mediation does not include formalism of any kind, but still, it includes legal, as well as psychological, sociological, financial aspects of party relationship (Šimac, 2006, p. 612). On the other hand, building management is very live and demanding area, which requires detailed regulation. Considering the fact that external building managers (external building managers are usually companies which are specialized for area of building management and which have signed contracts with the co-owners, unlike internal managers who are usually co-owners of building in question) works with huge numbers of co-owners, especially in big cities with the huge population, it is easy to conclude that conflicts are unavoidable on a daily basis. Managers have to find a way to obtain the best possible solution for every co-owner which is at the same time acceptable for a majority of co-owners or even for all of them. One of the main reasons for out-of-court mediation in neighbours' disputes is also place over which dispute arises, home.



Actually, people meet conflicts where they feel safe and secure (Knapp, 2015, p. 19). Neighbour's conflict could be perceived very stressful since they occurred in one's personal living space (Philadelphia, 2014, p. 25). Education and training for mediators are narrowly regulated in most countries. The situation is similar in Croatia. Since 2003 Croatia has regulated filed of mediation (Zakon o mirenju, Official Gazette No. 163/03, 79/09, and Zakon o mirenju, Official Gazette No. 18/11, hereinafter: Mediation Act). Republic of Austria is country with the highly regulated mediation area (Zivilrechts-Mediations-Gesetz, Official Gazette No. 29/2003, hereinafter: Austrian Mediation Act). This was the first mediation act enacted in Europe (Gherdane, Roth, 2013, p. 247). Regulation of mediation in Austria could serve as a role model for Croatian legislator (e.g. to become mediator in Austria one has to go through long and detailed training and to satisfy general requirements prescribed by law: minimum age, professional qualifications, trustworthiness, professional liability insurance). Just as in the field of mediation, Austrian legislator could be a role model for Croatia in filed of housing law, too. Austrian code (Wohnungseigentumsgesetz, Official Gazette No. 2002/70) specifically defines the position of managers and co-owners in extra-contentious, as well as in contentious proceeding, but also one, for the Croatian law unknown party in the judicial proceeding, manager of the community of co-owners (Maganić, 2007, p. 9). It is, also, important to highlight the engagement of Austrian local units, as City of Vienna (<https://www.wien.gv.at/wohnen/schlichtungsstelle/>) or Salzburg (<http://www.salzburg24.at/miteinander-wohnen-so-gehts-konfliktfrei/5080626>), in resolving disputes which includes implementation of real property law. Local units in Austria offer and manage out-of-court proceedings for resolving such disputes, e.g. disputes between neighbors. Considering the development of legal systems, but also economy and human needs it is recommendable for Croatian legislator but also for building managers to take place in education and training their staff for mediation in the area of building management. Namely, using mediation will create multiple benefits for managers as well as for co-owners with satisfaction on both sides as of the pretty consequence of mediation.

## **2. MEDIATION - TERM AND BASIC FEATURES**

Contemporary legal science and practice give significant benefits to mediation in relation to court procedure. What is mediation and is it and if yes, why is it better from court procedure? According to Oxford Dictionary of Law mediation is alternative dispute resolution in which an independent third party assists the parties involved in a dispute to achieve a mutually acceptable resolution (Oxford Dictionary of Law, 2009, p. 348) and mediator who may be lawyer or a specially trained non-lawyer, has no decision-making powers and cannot force the parties to accept a settlement (Oxford Dictionary of Law, 2009, p. 348). Settlement reached in process of mediation is not binding for parties, but regarding the fact that parties independently come to the decision probably, they will respect it. According to the Croatian law, this settlement is not enforceable order, unless it includes enforcement clause (Mediation Act, Art. 13, para. 2). Namely, the court is not involved in this procedure. Mediation is based on party interests, but not on the rights any of them. One of the most important particularities of mediation is the special method of negotiation, so-called Harvard method. The most important rules of Harvard method of negotiating are: separate the people from the problem, focus on interest, not positions, invent options for mutual gain, insist on using objective criteria (Fisher, Ury, Patton, 1991, p. 13). Harvard method is directed on interests, but not on the problems. The base of every conflict is not in positions, but in the conflict between needs, concerns, fears, and interests of each side (Fisher, Ury, Patton, 1991, p. 24). Mediation is process, which is, ipso iure, simpler, faster and more effective than the court procedure. Parties, themselves, are accepting the fact of existing dispute between them, and are ready to talk about it and to resolve it on a mutual satisfaction.

The first benefit of mediation is its price. Namely, mediation is process much cheaper than the court procedure. The most common situation is that parties have to pay a certain amount of money like the deposit for mediator or institution which organizes whole procedure (e.g. Croatian Chamber of Commerce or International Chamber of Commerce). There are many reasons of people's distrust in judicial systems, but the most common are great costs of the courts and lawyers, hard and arduous way for acquiring judicial protection (Šimac, 2006, p. 612). The second benefit of mediation is confidentiality, which makes mediation applicable in emotional or highly sensitive issues (Nauss Exon, 2014, p. 4). Everything that is said in the mediation room stays in that room. The principle of confidentiality of mediation procedure obliges not just parties and mediator, but also, all who may gain access to what is said in mediation (e.g. legal advisers, experts consulted, auxiliary staff) (Morek, 2013, p. 426). Since there is no publicity in the mediation, parties are free for expressing their views and emotions regarding the conflict. There is no possibility for the awkwardness of any kind and here we come to the restitution of confidence between parties and catartic, calming atmosphere mediation can create (Nauss Exon, 2014, p. 4). The third thing that encourages mediation as a process of resolving of disputes is that all aspects of party relationship will come out (Šimac, 2006, p. 612) and this will cause for parties to more steadily look on the whole situation after which they will easier take place of the other side. Taking shoes of the opposite party will enable them to pay attention to the relationship and to focus on the future. Actually, mediation is about creating trust and communication and its consensual nature enables parties to preserve the relationship and to rebuild it (Nauss Exon, 2014, p. 5). Mediation is not about compromise or losing anything, but it leads to a *win-win* situation for both parties, and that is why mediation is suitable for broken relationships in which parties must continue their cooperation or lives together, such as relationships between business partners, co-workers, neighbours. Special kind of mediation that is appropriate for disputes, such as those between neighbors, is mediation in a community.

## **2.1. Mediation in a community**

Mediation in a community means dispute resolution in process of mediation in a certain social community (e.g. neighborhood) or between citizens and certain social community. In the community mediation parties are usually laics in the field of law (Duffy, Grosch, Olczak, 1991, p. 24). In most of those cases, shared future by the parties is one of the main reasons for taking part in mediation, namely, parties have long-term, ongoing relationships (Duffy, Grosch, Olczak, 1991, p. 30), such as co-owners or neighbors.

### *2.1.1. Mediation in building management*

Most of the world population lives in big cities, in multi-storey residential buildings in which building management disputes are very often. There are, usually, very complex issues over common parts of buildings (Department of Justice, The Government of the Hong Kong, Special Administrative Region, Report of the working group on mediation, 2010, p. 20). There are different kind of conflicts that are suitable for mediation in building management, issues over management fees, breach of duties by co-owners, water leakage, unauthorized use of common parts of the building, pets raising (<http://mediation.judiciary.hk>). Co-owners and building managers could find great reasons for accepting community mediation (e.g. in the dispute over common reserve, or using common parts of building, mediation has very much to offer). In those disputes, every party has the interest to continue „collaboration“ or living at the same address, in the same building and with the same neighborhood. It is very hard to imagine a case in which conflict is so difficult that one party decide to sell his or her apartment or any other special part of the building. On the other hand, civil engineerings and building managers often witness arguments in the co-owners community, especially regarding decoration of common

parts of the building. Considering the future interests, mediation is particularly applicable in those disputes, and having building manager and mediator in the same person is very attractive for most communities of co-owners. Negotiation skills are very important in those situations. Building managers could have multiple benefits if they educate their staff for mediators. In this way, the procedure would be cheaper and faster. Another kind of situation in which is useful to have building manager, good mediator and educated and prepared negotiator in the same person is a conflict between a community of co-owners and body of local government (e.g. disputes over an adaptation of building). In those kind of disputes, both parties (co-owners and a body of local unit) want a reliable person as a mediator whose work they have already met, and there is also open space for building managers as mediators. It could be said that tactics like trust development and call for caucus are the most versatile tactics in those disputes (<https://ascelibrary.org/doi/abs/10.1061/%28ASCE%29ME.1943-5479.0000230>). There are just some of the possible situations in which building managers and co-owners would have common benefits from the mediation, but the experience of every country is different in this area (e.g. Hong Kong is the first administrative region which has enacted mediation in building management before courts), so are Austrian and Croatian.

### 3. MEDIATION IN AUSTRIA

Republic of Austria is European pioneer in the codification of mediation area (Gherdane, Roth, 2013, p. 247). The first area in which Austria has regulated mediation as an alternative to court procedure is family law and that was in 1999 (Gherdane, Roth, 2013, p. 247), in 2004 Austria enacted *Zivilrechts-Mediations-Gesetz* (Act on Mediation in Civil Law Matters, Official Gazette No. 29/2003, hereinafter: Austrian Mediation Act). That was the first mediation act in Europe (Gherdane, Roth, 2013, p. 247). This code regulates the process of mediation and answers on the questions who can be a mediator, and how to become a mediator in Austria. Austrian mediators are organized in professional organizations and Austrian Federal Association for Mediation (*Österreichische Bundesverband für Mediation (ÖBM)*) represents itself as the biggest interest group specialized for mediators in Austria, as well as in European Union (Gherdane, Roth, 2013, p. 247). According to the Austrian Mediation Act to become a mediator one has to through training regulated by the Austrian Mediation Act and Regulation on training for mediators (*Zivilrechts-Mediations-Ausbildungsverordnung*, Official Gazette No. 47/2004). General requirements for inclusion in the roster of registered mediators kept at the Federal Ministry of Justice ([https://e-justice.europa.eu/content\\_mediation\\_in\\_member\\_states-64-at-en.do?member=1](https://e-justice.europa.eu/content_mediation_in_member_states-64-at-en.do?member=1)) are: minimum age for registration is 28 years, professional qualification, trustworthiness, professional liability insurance (Austrian law must be applicable; minimum insurance cover is EUR 400,000 and there is no exclusion or time limitation of the continuing liability) (Austrian Mediation Act, Art. 9 and Art 19. Para 2). The Austrian Federal Minister of Justice maintains a list of training institutions (*Ausbildungseinrichtungen*) for mediation in civil law matters (<http://mediatorenliste.justiz.gv.at//mediatoren/mediatorenliste.nsf/contentByKey/VSTR-7DYGZV-DE-p>). This list includes also some universities (the Sigmund Freud University Vienna, the Carinthia University of Applied Science and the Johannes Kepler University Linz). To become a mediator person has to complete training in the institution mentioned in the list. The training for mediator has two parts (theoretical: 200-300 training units and practical: 100-200 training units) (Austrian Mediation Act, Art. 29 para. 2). The training shall be considered appropriately (Austrian Mediation Act, Art. 29 para. 3) and that means to consider a knowledge gained by and the level of completion of qualification of the members of specified professions (e.g. Lawyers, Notaries, Psychologists, Judges, Clinical Psychologists, Social Workers etc.) (Austrian Mediation Act, Art 10 para. 2). When the person is successfully registered that registration remains active for five years (Austrian Mediation Act, Art. 13 para 1), but within period of 5 years the registered mediator

has to complete at least 50 hours of professional education and evidence this to Federal Ministry of Justice every five years (the term „professional education includes participation in expert seminars, workshops, case analysis, part-time supervision, etc.) (Austrian Mediation Act, Art. 20). Austrian system does not have any central authority with the responsibility for mediation services. There are some professional and non-professional associations offering mediation, as well as some non-governmental organizations ([https://e-justice.europa.eu/content\\_mediation\\_in\\_member\\_states-64-at-en.do?member=1](https://e-justice.europa.eu/content_mediation_in_member_states-64-at-en.do?member=1)).

### **3.1. Mediation in building management in Austria**

Austria today has mostly the internal system of building management (internal building manager is one of the co-owners), but this system is appropriate for small buildings only, so the number of buildings with the external building managers has increased recently. Austrian law, also, recognizes one more subject in building management, the manager of the community of co-owners (Maganić, 2007, p. 5). The system is careful regarding protection of rights of co-owners (e.g. co-owner must be represented by an attorney at law, a notary or so-called representative of interests of co-owners (Interessenvertreter) (Maganić, 2007, p. 11). Despite all regulation of the legal position of co-owners and their community in the court procedure, Austrian law prescribes mandatory mediation in some neighborhood disputes before the case can be brought to the court ([https://e-justice.europa.eu/content\\_mediation\\_in\\_member\\_states-64-at-en.do?member=1](https://e-justice.europa.eu/content_mediation_in_member_states-64-at-en.do?member=1)). The other way of taking this procedure is referring the matter to the conciliation board trying to seek a pre-trial settlement through district court. This procedure is also known as a „prätorischer Vergleich“ (<https://www.help.gv.at/Portal.Node/hlpd/public/content/101/Seite.1010160.html>). Austrian legislator has recognized the advantages of neighborhood mediation 14 years ago (Philadephy, 2014, p. 25). The legislator has for the first time introduced out-of-court dispute resolution mechanisms in neighboring law by enacting Civil law Amendment in 2004. According to the Art. 3 of Zivilrechts-Änderungsgesetz from 2004 (Civil Law Amendment Act, Official Gazette No. 91/2003, hereinafter: ZivRÄG 2004) neighbor has to submit a dispute to a mediator before commencing a lawsuit if there is a dispute related to withdrawal of light or air through foreign trees or plants. Still, this law does not deny the voluntary nature of mediation. The mediation in those disputes is possible if the owner of the tree or plant agrees on that (Schuster, 2013, p. 11). ZivRÄG 2004 was the first act in Austria regarding mediation in neighbors' disputes. Actually, pursuant to Art. 3 of ZivRÄG 2004 mediation is one of the three possibilities (Schuster, 2013, p. 11). Austrian court practice witnesses that cost risk and burden of proof are the most often reasons for taking mediation in when comes to disputes because of the noise (Knapp, 2015, p. 19). Local communities in Austria are also included in the resolution of disputes between neighbors or disputes over ownership. Namely, City of Vienna has organized special body, Vienna conciliation board (Wiener Schlichtungsstelle) which is empowered to resolve disputes over real property (<https://www.wien.gv.at/wohnen/schlichtungsstelle/>), but it is explicitly stated that Vienna conciliation board cannot represent co-owners or their community before the court (<https://www.wien.gv.at/wohnen/schlichtungsstelle/>). Therefore, this is the body of the local unit which offers services of extra court dispute resolution. Procedure before Vienna conciliation board starts when the body receives a petition for dispute resolution. The board delivers a petition to the other party and gives an opportunity to this party to respond. Parties can demand oral proceeding before the board. The oral proceeding, if it is demanded, is taken in a way of mediation. The decision made before the Vienna conciliation board is not binding for the parties, so dissatisfied party has the ability to go before the municipal court in a four weeks after delivery of this decision, but if neither party takes next step before municipal court, the decision of the Vienna conciliation board becomes obligatory for parties (see: <https://www.wien.gv.at/wohnen/schlichtungsstelle/verfahrensablauf.html>).

All steps taken in this procedure are tax-free and every party covers its legal fees (<https://www.wien.gv.at/wohnen/schlichtungsstelle/kosten.html>). This is a conciliation board, thus it provides another kind of out-of-court procedure, but similar to mediation. Since, the decision made by Vienna conciliation board can become definitive and obligatory for the parties, this body has to have educated experts in the field of ADR, who are aware of their role in the process. The board is also in charge for consulting with the citizens on using apartments and offices. As it could be seen, Austria does not have special regulations on mediation in building management but has a narrowly regulated field of mediation in civil disputes and field of real property in buildings with the special attention on protection of co-owners' rights. Also, Austrian local units often offer services similar to mediation to resolve disputes such as neighbors' or between the tenant and the landlord. History teaches us that countries of German legal area are role model for Croatian legislator. Does Croatia have something to learn from Austrian experience?

#### 4. MEDIATION IN CROATIA

First Croatian Mediation Act (Zakon o mirenju, Official Gazette No. 163/03, 79/09) was enacted in 2003. At that time Croatia didn't have any practical experience in mediation (Babić, 2013, p. 214). The most important principle on which the whole Act was based was the principle of party autonomy. This principle was affirmed as the most important in the set of amendments from 2009 (Babić, 2013, p. 215). Today, the most important legal source that governs mediation in Croatia is Mediation Act from 2011 (Zakon o mirenju, Official Gazette No. 18/2011, hereinafter: Mediation Act). The Act governs in civil, commercial, labor and other disputes concerning the rights which are at the parties free disposal (Mediation Act, Art. 1, para. 1). Mediation in specific law areas, such as consumer protection, is governed by specific law act as *lex specialis*. According to the mediation Act „mediation“ is any process, whether conducted in a court or any other institution or without participation of any institution (*ad hoc* mediation), in which parties attempt to reach a settlement of their dispute with the assistance of one or more persons who have an authority to impose a binding solution (Mediation Act, Art. 3). This Act, under the same conditions, governs out-of-court, as well as court-annexed mediation. Offering service of mediation is not regulated by law (Babić, 2013, p. 217). Still, some mediation institutions when meets certain standards may apply for accreditation by the Ministry of Justice (Babić, 2013, p. 217), but this accreditation doesn't give any particular powers to the institution (Babić, 2013, p. 217). Some of the institutions offering mediation services in Croatia are Mediation Centre of the Croatian Chamber of Commerce, Croatian Mediation Association, Croatian Insurance Office, Croatian Bar Association etc. Mediation Act defines „mediator“ as a person who conducts mediation on the basis of an agreement of the parties (Mediation Act, Art. 3, para. 2). The Act does not prescribe any mandatory requirements that a person must satisfy in order to legally practice mediation (Sajko, 2011, p.16), but in 2009 the Ministry of Justice enacted the system of public registration, which enables persons and institutions who meet specific requirements, prescribed by Regulation on register of mediators and standards for accreditation of institutions for mediation and mediators (Pravilnik o registru izmiritelja i standardima za akreditiranje institucija za mirenje i izmiritelja, Official Gazette 59/2011, hereinafter: Regulation) to become „registered mediators“. According to the Regulation, mediators who meet certain requirements regarding training and education, have right to be recorded by Ministry of Justice (see: <https://pravosudje.gov.hr/UserDocsImages/dokumenti/Pravo%20na%20pristup%20informacijama/Registar%20izmiritelja.pdf>). It is important to highlight that registration is voluntary (Regulation, Art. 3, para. 1), but considering the social importance of mediation process (especially the fact that this process is applicable in socially sensitive situations), it is recommendable to prescribe mandatory registration, as well as training for all mediators.

Training for mediators is prescribed by Regulation (Art. 11). It includes two types of training: basic and additional. Basic training is carried out in a group of 24 persons max, duration of 40 hours min and has two components: a theoretical part and a practical part. In theoretical part candidates for mediators are going through the definition of mediation, principles of this process, goals, different methods, the legal framework in Croatia and European Union (Regulation, Art. 11, para. 1). Practical part means learning from experience (playing roles, simulation of cases, training skills like listening, maintaining the balance of powers etc.) (Regulation, Art. 11, para. 1). Additional training can also be carried out in a group of 24 persons max, who are certified mediators, duration of 20 hours min (Regulation, Art. 11, para. 2). This training, as well as basic training, has two components, theoretical and practical. Every registered mediator has obligation of taking an additional training every two years. According to the Mediation Act, mediators are appointed in accordance with the rules agreed by the parties (Mediation Act, Art. 7, para. 1). The mediator is third, independent and impartial person, and due to Art. 8 of Mediation Act mediator has duty to disclose all information which could give rise to justifiable doubts about his or her impartiality and independence. Having in mind all previously said one could conclude Croatia has similar system to Austrian, but there are some differences. The most visible are, however, duration of training for mediators and voluntary nature of registration in Croatia. How far has Croatia come regarding mediation in one specific area, mediation in building management, and is there room for improvement?

#### **4.1. Mediation in building management in Croatia**

Building management in Croatia is regulated by Real Property Act (Zakon o vlasništvu i drugim stvarnim pravima, Official Gazette No. 91/96, 68/98, 137/99, 22/00, 73/00, 129/00, 114/01, 79/06, 141/06, 146/08, 38/09, 153/09, 143/12, 152/14) and Regulation on maintenance of buildings (Uredba o održavanju zgrada, Official Gazette No. 64/1997). There are now some initiatives for new Act on managing and maintaining of buildings (see: <http://www.udrugastanara.hr/hr/propisi/236>). However, building management is very dynamic area, but for Croatian circumstances, also developing activity. Building managers in Croatia are mostly organized as legal persons and considered as experts in their area of work. Having that in mind, it must be said that those building managers are obliged to act with the increased attention, according to the rules of profession and good customs (professional diligence) (Obligations Act, Art. 10 para. 2, Zakon o obveznim odnosima, Official Gazette No. 35/05, 41/08, 125/11, 78/15, 29/18). Thus, it is very important for all building managers to have good legal knowledge, but also to offer its customers good legal service. Talking about mediation in building management in Croatia, one must admit that there is no specific experience or practice in this area. Different mediation institutions and mediators offer mediation in neighbors' disputes, but unlike Austria, we don't have specialized persons or bodies for this type of mediation, or any other type of ADR in this area. At this point, Croatian mediators as well, as building managers, have to think about one new service to provide. Everybody can see the utility of mediation provided by building managers or mediators specialized in this part. Building managers as mediators in neighbors' dispute, or in dispute between co-owners and body of local unity could save time and money for both parties. They are already familiar regarding the conflict situation and it makes them suitable for anticipating the best possible solution, for individuals and community at the same time. When the worst thing is to see the guy next door, the only thing that remains is to make common interest visible (Silvester, 1987, p.7).

#### **5. CONCLUSION**

Have we made any progress regarding condominium? Condominium is, still, *mater rixarium*, but there are some ways of solving disputes without participation of judges in their main role,

but as mediators, third, independent party without any power to make mandatory decision for parties. Austria as the first country in Europe with the comprehensive regulation of mediation in civil disputes could serve as role model for Croatia. This country has developed system of mediation in neighbors' disputes in which local units (e.g. Vienna, Salzburg, Linz etc.) are included as well. On the other hand, Croatia is at the beginning of a journey and still, cannot be proud on its system of mediation or any other ADR in neighbors' disputes. At this moment Croatian legislator could think about mandatory registration, which would, for sure, lead to a bigger quality of the services mediators offer. Building management as an active area in which changes are imminent and it demands narrow regulation and educated staff. Austrian law has detailed provisions on residential property and again, it could be an example for Croatian legislator. It is time to start thinking about new solutions on maintaining of buildings as well as relationships in community of co-owners. Mediation as the process which aims at generating satisfaction on both sides, here specifically for co-owners, or co-owners and building managers, is highly applicable in disputes regarding co-ownership, especially in big buildings with the huge number of co-owners (see: <https://www.croatiaweek.com/croatias-largest-building-approaching-40th-anniversary/>) . Court judgment will, maybe, silence the noise, but often it displaces the conflict on the other level, usually, escalating one (Knapp, 2015, p.19). Mediation, on the other hand, means one step towards the common solution (Knapp, 2015, p. 19). Mediation also represents a possibility of reaching solutions that both sides find satisfying (Philadelphia, 2014, p. 25). Therefore, it is recommendable for building managers to educate their staff for mediators. In this way, they will have something more to offer. If co-owners have an opportunity to talk with the trained mediator who is at the same time their building manager, they will feel more satisfied, secured and all ideas would be discussed properly. In the end, the note from Zig Ziglar to building managers: “There is only one thing worse than training your staff and having them leave - and that's not training them, and having them stay.” (<https://www.ziglar.com/quotes/employees/>).

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## **SOCIAL AND RENTAL HOUSING AS ONE OF THE CONDITIONS OF INTERNAL MIGRATION FOR WORK - ON THE EXAMPLE OF THE SLOVAK REPUBLIC**

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### **ABSTRACT**

*The Slovak Republic is specific for its large regional differences. These are predominantly in terms of unemployment, income levels and the resulting social situation and region's maturity. Migration for work could be a solution. Among other conditions, however, it primarily assumes the possibility of adequate housing. This could be ensured through rental housing. The public housing sector consists of flats and houses owned by towns and municipalities. The hired public housing sector is identical to social housing. This segment of housing is subject to a significant degree of regulation of state housing policy. Through its tools, the state regulates and corrects the construction, respectively the development of social housing and, in particular, the target population for which the type of housing is primarily intended. The negative impact of the preference of private property housing by households is low labor mobility, the risk of housing loss in case of failure to pay for the purchase of an apartment and, last but not least, the indebtedness of families and individuals over their entire decades of life. Private property housing is mainly intended for middle and higher income groups of the population. Within Slovakia, the bulk of migration for work is directed to Western Slovakia. People come from less developed regions of Slovakia especially to Bratislava and the surrounding area. The article deals with the possibilities of the capital city in the field of social housing in the interests of unemployment and migration within the Slovak Republic.*

**Keywords:** *housing supply, labor migration, rental housing, unemployment*

### **1. INTRODUCTION**

The distribution of the population and its regional movement play an important role in regional development, especially migration between regions associated with a change in permanent residence and commuting to work, which is typically not associated with a change in permanent residence. (Biswas et al., 2009). Internal, inter-regional migration is of a different character than international migration. It is primarily based on the “exchange of skills”, especially between those regions in which economic factors are the fundamental driving force of migration. Decisions to move a longer distance (in the case of higher-ranking regional units) are influenced by economic as well as cultural and social conditions (Biswas et al., 2009). However, it is this internal labour migration that provides people with economic resources, either through better paid employment or simply by providing the opportunity to find work at all. Labour mobility inside Slovakia is an important phenomenon, where people commute to work through multiple regions. Commuting to work may be divided by periodicity into daily, weekly and monthly commuting, etc. Labour mobility has a negative impact on non-homogeneous loading, for instance of infrastructure. If only internal (domestic) migration is considered, several reasons may be identified that encourage researchers to intensively study migratory mobility. One of them is the intimate relationship between migration and other phenomena and processes in the spatial organisation of a society. Migration actively impacts its spatial organisation while also reflecting many of its changes and development trends. This specifically concerns the role of migration in regional labour markets and housing markets, and its relation to other forms of population mobility, such as moving for work or education, and its impact on the character of the regions of origin and destination, especially in terms of migrants’ demand for work, housing

and social services. Social housing supports labour force effectiveness and mobility, population growth, family size, the development of personal and interpersonal relationships and other sociological and democratic indicators that have immediate political and economic impacts. The public rental housing sector includes flats and buildings owned by cities and towns. The public rental housing sector is identical in scope to social housing. This housing segment is highly subject to state housing policy regulations. Using the tools at its disposal, the state stipulates and corrects the construction and development of social housing and especially target groups

## **2. SOCIAL RENTAL HOUSING IN SLOVAKIA**

When social housing was first constructed and rented, the primary applicants in general were poorer, but also employed families, typically with two adults and children. During recessions, the employment prospects for these households declined, and they were often among the most affected groups during economic restructuring. The inhabitants in this area also got older. These populations grew older and poorer. The quality of the buildings and the quarters themselves declined as well and in this regard the nature of social housing policy has a negative role. (Zúbková 1999) the population for which this type of housing is primarily intended. (Brňak 2017). Three basic definitions of social housing are encountered in literature and in practice in many European countries and are based on type of ownership and the method of financing this housing.

1. In the simplest sense, social housing is identified with the public rental sector, i.e rental housing stock owned by towns and cities.
2. in a broader sense, social housing is also includes rental housing stock owned by non-profit organisations (private law entities), cities, towns, housing associations and condominiums in extraordinary instances.
3. The broadest understood definition of social housing is based on the method of financing and defines social housing as any housing where public funds were used to some extent in their construction or operation (this includes privately-owned rental housing drawing support from public funds) (Zúbková, Brázdovičová 2008).

The objective of social housing is to secure adequate and dignified housing for individuals and families who cannot afford housing on their own or others who are provided care through selected social services. The requirements that EU member states currently place on social housing as a prerequisite for professional discussion are accepted in Slovakia. Social housing requirements (Zúbková, Brázdovičová 2008):

- support for weaker social strata to obtain housing must be a permanent part of housing policy,
- support for economically weaker households must be addressed and effective and accompanied by rigorous monitoring of the need for support,
- support for disadvantaged households must be understood as support and not a social service, meaning that every user must contribute to their housing in an appropriate manner,
- social housing should not be understood as isolated housing stock; rather it should be seen as less expensive housing that may be implemented in various parts of the real estate market using a combination of financial support and legislative tools,
- access to social housing and to assistance for the weaker parts of society should be facilitated in relation to other areas of housing policy, in particular support for housing construction,

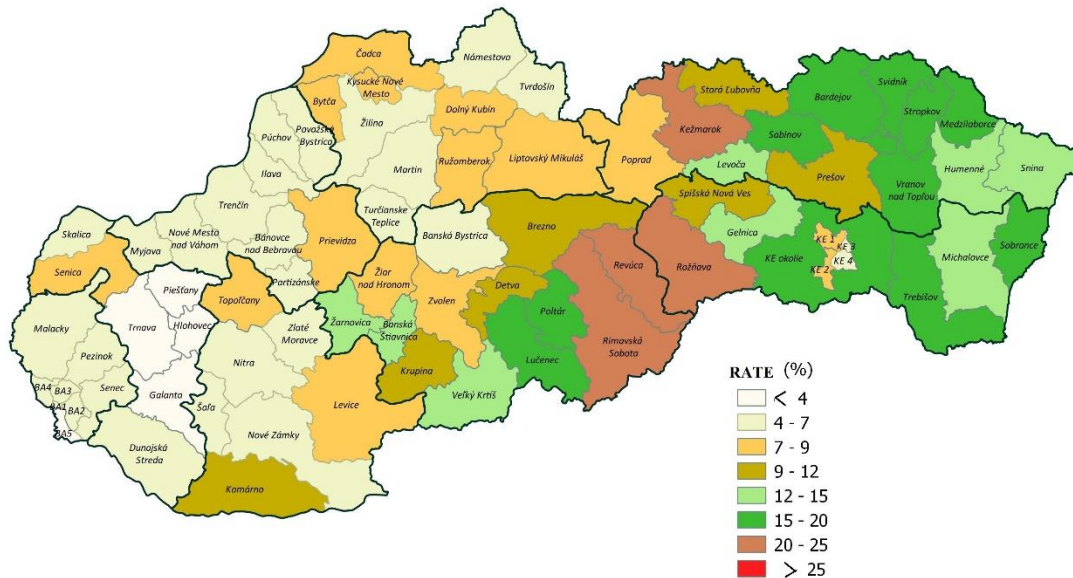
This understanding of social housing should permit economically weaker households to live in decent dwellings and without exposure to concentration or segregation.

Slovakia applies a dual model of social housing. Social housing secured through construction projects using public funds is legislatively divided into social housing in standard flats and social housing in flats of a lower standard. These types of social housing do not have legislative standing at the same “qualitative” level. Social housing is defined in legislation in §21 (1) of Act No. 443/2010 Coll. on Subsidies for Housing Development and Social Housing. The basic trait defining social housing is the direct connection to public financing, meaning that all flats, houses, blocks of flats, etc. that use public funds for construction or housing and accommodations financed using public funds are included in social housing. The objective of social housing is to secure adequate and dignified housing for individuals and families who cannot afford housing on their own or others who are provided care through selected social services. For this reason, rental housing owned by towns and cities is identical to social housing. Likewise, selected social services in which dependent clients, as defined in Act No. 448/2008 Coll. on Social Services, as amended, are provided care connected with accommodation such as facilities for the elderly, social services homes, nursing care facilities, shelters, dwelling houses, halfway facilities, emergency housing facilities and others are also considered social housing (Brňak 2017). Slovakia uses state housing policy to define the disadvantaged groups in the population on the housing market, which include low-income households, young families, large families, seniors, single-parent families, women at risk and victims of domestic violence, aliens and migrants, the homeless and households living in socially excluded locations. Other groups of people who are so disadvantaged for a variety of reasons that they are unable to satisfy their own need for housing are also included here. Social housing may be used by individuals / households with monthly household income of up to three times the subsistence minimum or up to four times the subsistence minimum if a member of the household is severely disabled, if it is a single-parent household with a dependent child or if at least one member of the household provides healthcare, social and general social services, education, culture or security for the community. The housing sector in Slovakia may be divided into the private and public rental sectors. The private sector includes the private rental sector and privately-owned housing. The public rental sector accounts for ~2.5% of total housing stock, while the private rental housing sector is even lower at around 0.2%. (Ministry of Construction and Public Works, 2012) The representation of the individual sectors varies in EU member states. The farther east and to the south a European country is, the greater the decline in the share of the private rental sector and the public rental sector, i.e. social housing. Privately-owned housing has a prominent position in the private sector. Nearly 90% of the flats and houses in Slovakia are privately owned. (SODB, 2011) Within the EU, the private sector has higher representation in countries such as Estonia, Bulgaria or Romania. Conversely, in Germany, the share of private ownership fluctuates at a level of 40%. In the countries of the southern part of Europe, the representation of privately-owned housing is higher than in the northern countries. In Slovakia, private ownership of housing is one of the most preferred methods of securing housing. There is also an insufficient supply of private rental housing and an equally low supply of social housing. A negative impact of the preference for private ownership by households is low labour mobility, along with the risk of losing this housing due to an inability to meet obligations to pay for the purchase of a flat and the fact that families and individuals go into debt for entire decades of their lives. Privately-owned housing is primarily intended for the middle and upper income groups of the population. (Prohuman 2017)

### **2.1. Social rental housing in Bratislava**

In addition to being the capital of Slovakia, Bratislava is also where the greatest population movement is observed. This is underpinned by commuting for work from regions with higher unemployment.

Figure 1: Unemployment rate in regions 31.12.2016 (Ministry of Labor, Social Affairs and Family of the Slovak Republic)



At the current price level on the real estate market, housing remains inaccessible for low-income, migrating population groups. The question of rental housing remains one of the most important. It is noteworthy that the Bratislava Region formed as the most attractive region in terms of domestic migration in the period from 2005 to 2009, during which time its average annual gain was 2,354 people (3.86%). In terms of the spatial distribution of gains and losses, it is clear that the gains are more and more concentrated in western Slovakia, especially in the Bratislava Region. Losses are primarily connected to areas that are less prosperous and where there is a lack of jobs. The Bratislava Region is the most attractive area to which migration flows are currently directed. There is a logic behind this movement, as the Bratislava Region is the most economically advanced in the country with regional per capital GDP at purchasing power parity at 148.7% of the EU (where the EU = 100 %), which ranks it 20th among the 275 regions (NUTS2) of the EU.<sup>3</sup>

	Region							
	Bratislava	Trnava	Trencin	Nitra	Zilina	Bystrica	Presov	Kosice
Number of internal immigrants								
2016	10 349	4 870	2 720	3 444	2 511	2 516	2 814	3 348
2015	10 253	4 625	2 520	3 126	2 398	2 286	2 377	3 109

Table 1: Number of internal immigrants in region of SR (Ministry of Labor in SR)

In the case of renting a standard flat, rental contracts are concluded for a maximum of 2 years with the ability to repeatedly extend such contract if certain conditions are met, but the maximum lease term is not defined and ultimately represents a permanent housing solution for those who meet the defined conditions.

The conditions for renting apartments are as follows: the applicant does not have a place to live on the grounds that they are not a tenant or owner of an apartment or a house or there are extended delays in enforcing their right to live in a dwelling by court, they have permanent residence in Bratislava and receive income of at least 1.2 times the subsistence minimum determined by law. A committee formed at City Hall makes decisions on the assignment of these flats based on a number of conditions, some of which include: the applicant has been on the list of applicants for at least 3 years, there is an urgent need for housing, a member of their household has a serious medical problem, or the applicant or a member of their household provides healthcare, education, culture or security for the community, the applicant or a member of the household performs socially important occupation whose performance is connected to the capital and who lacks housing in the city, if there is a requirement to secure replacement housing based on a valid decision of a court or under applicable provisions of the civil code, the number of dependent children in the family and other factors. The size of the assigned flat depends on the number of members of the household, but is limited to a maximum of a 4-room flat (3-bedroom flat) for 5 or more persons.

House for young families - this is a project intended to help young families with under-age children, including one-parent family, and young married couples who want to start a family while resolving the issue of housing. Housing in this case is provided as a fixed-term rental. The contract is concluded for two years, with the option to extend the term for an additional two years, for a total term of up to ten years. Some conditions for inclusion in the project include: flats in the project are assigned to families with young children (including one-parent families) married couples under the age of 35 with permanent residence in Bratislava for at least one year, at least 6 months of employment or one of the applicants may be on maternity leave or in business as an entrepreneur, the applicant's income must be higher than twice the subsistence minimum while the income cap is four-times the subsistence minimum, no ownership of a flat, house or apartment building, and others.

House for seniors - this project provides housing for inhabitants over the age of 50. Flats are leased under conditions specified in the rules of the house for seniors. Leases are concluded for a minimum of 2 years. The maximum term is not limited in any way. An applicant must be over the age of 50 with no place to live as they are not a tenant or owner of a flat or house or they are experiencing long delays in enforcing their right to live in a flat via the courts, which prevents them from using a flat but did not lose the right to live in the flat by their own actions; an applicant must have permanent residence in Bratislava for at least five years and their income must exceed 1.2 times the subsistence minimum.

In addition to 12 flats for the disabled, the third form represents a number of options for protective housing for disadvantaged groups of the population. Common to them all is the aspect of temporary accommodation, largely functioning to cover a bridge periods, and the condition that disadvantaged, at-risk groups be served.

### **3. CONCLUSION**

Social housing includes all flats, houses and blocks of flats the acquisition of which used public funding or housing and accommodations financed using public funds. Social housing in the EU is provided to households that are unable to secure housing on the housing market for themselves because of their income or discrimination or because these households are not attractive to financial institutions, which excludes them from the opportunity to secure their own privately-owned housing (e.g. via mortgage). The prices of flats have changed minimally in recent months. The average price is currently €1,475 per square metre.

The most expensive is Bratislava, where the price has exceeded the €3,000 threshold in certain places. For comparison, the purchase of an older, 3-room (2-bedroom) flat measuring 70 m<sup>2</sup> in the capital would cost you €154,000, while the same flat would cost €93,000 in eastern Slovakia and less than €80,000 in central Slovakia. The supply of social housing is also insufficient inside Bratislava. The organisation and legislation concerning rental housing do not support migration for work as a prerequisite for improving living conditions for the population since it is almost unconditionally linked to the maintenance of conditions concerning permanent residence.

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## IMPLEMENTATION OF THE STRATEGY FOR PUBLIC ADMINISTRATION DEVELOPMENT IN CROATIA (2015-2020): A MID-TERM EVALUATION

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### ABSTRACT

*Paper analyses the implementation process of the Strategy for public administration development in Croatia (2015-2020) that was adopted by the Croatian Parliament in 2015. The adoption of the Strategy is mainly a result of external pressures and mostly conditioned by the conditionality rules of the EU structural and investment funds (ESI). The lack of authentic devotion of domestic actors to public administration reform is evident during implementation process as many of the proclaimed goals are attained with great difficulties and delays and some of them are not accomplished at all. After the introductory chapter paper proceeds as follows: second chapter describes and analyses political and economic context in which the Strategy was adopted as well as the state of public administration in Croatia at that time. Third chapter critically analyses the content of the Strategy, its individual objectives and measures, their coherence and appropriateness for addressing main challenges of public administration in Croatia. Fourth part of the paper is dedicated to the implementation process of the Strategy and to the identification of problems and shortcomings that severely jeopardize its proper implementation. Conclusive remarks and main insights of the analysis comprise the final chapter. They are the basis on which several propositions and policy recommendations are formed that are necessary prerequisites for the modernization of Croatian public administration and for the adoption of main European administrative standards.*

**Keywords:** public administration reform, Croatia, implementation, evaluation, Europeanization

### 1. INTRODUCTION

Facing complex and dynamic environments, public administration systems across the world have been exposed to a constant need for adaptation and change. It would not be wrong to state that public administrations have been in continuous state of development and reform. This is particularly the case with the group of ex-socialist countries from central and Eastern Europe which Croatia is part of. In these countries public administrations had to be subjected to large-scale reforms in order to adapt to the new political and economic environment and to be able to serve as a tool for the management of wider social transformations (Škarica, 2012, p. 363). During the early transition period administrative reforms usually lagged behind in comparison with economic and political overhauls. Later on, reforms in public sphere predominantly took the path of Europeanization – accession to the European Union was the main impetus for change and principles of European administrative space guided the proclaimed objectives, but results and outcomes were often only moderately successful (DeVries, 2017; Koprić, 2017a) and common model of public management reform in Central and Eastern Europe have not emerged (Nemec, 2008, p. 343). Public administration development in Croatia in last 25 years has undertaken quite conservative trajectory, characterized with incremental changes and sporadic improvements, while deeper structural reforms and systemic reorganizations were avoided and still missing. As a rule, changes that were introduced rarely were based on long-term and strategic policies because no comprehensive strategic document for the holistic public



administration reform was ever developed<sup>1</sup>. Lack of strategic approach in administrative reforms reflected the overall weaknesses in policy-making, implementation, monitoring and evaluation capacities of Croatian public administration (Petak, 2013). The Strategy for public administration development for the period 2015-2020 (hereinafter: Strategy) was adopted by the Croatian Parliament in June of 2015, two years after the accession to the European Union. It was supposed to constitute a firm ground for the holistic approach to public administration reform and was met by great expectations from general public, media and academic community. Three years after, the document itself has been almost forgotten and without much reference in public, political and even academic discourse. Halfway through its implementing cycle, public administration reform has been developing rather slowly and with great hesitation from political actors. The text that follows tries to identify, describe and analyse main reasons for such a state and propose necessary adjustments. By examining the state of Strategy implementation, this paper has a task to understand the circumstances in political, economic and administrative arena and other factors that influence (laggings in) public administration reform and jeopardize the fulfilment of the proclaimed goals. Two groups of factors can be identified as most important – deficiencies of the Strategy itself and circumstances in political and administrative context of Strategy adoption and implementation. Although evaluations usually come at the end of a policy cycle, this ‘mid-term inventory’ could help to redefine some strategic objectives, to redirect the reform process that has been stagnating lately as well as propose necessary adjustments of governance structures that guide, coordinate and monitor public administration reform.

## **2. POLITICAL, ECONOMIC AND ADMINISTRATIVE CONTEXT OF STRATEGY ADOPTION**

Development of public administration in Croatia since its independence can be systematized in four distinctive periods (Koprić, 2008; 2011; 2017b): 1. Establishment phase (1990-1993); 2. Consolidation phase (1993-2000); 3. Europeanization phase (2001-2008); 4. Modernization phase (2008- ). Despite several reform attempts and certain accomplishments in day-to-day functioning, especially during Europeanization and modernization phases (see more in Koprić, 2011; 2017b), Croatia predominantly retained the traditional administrative model of hierarchical and centralized bureaucracy, insufficiently oriented towards the citizens and highly susceptible to political interventions. While Croatia, in a responsive, but mainly superficial manner, made certain steps forward in adjusting its public administration’s legal and institutional framework to European standards, the core structure and internal procedures remained arguably the same. Weak administrative capacity for strategic planning and policy implementation has been identified as the main problem of Croatian governance system (EC, 2017, p. 48). Many sectoral strategies were adopted only to be put away and never fully implemented, while a substantial number of them was insufficiently monitored and improperly evaluated. Inadequate organization, embodied in notorious fragmentation and multitude of administrative bodies as well as bureaucratized and reactive procedures continued to pose the main obstacle in establishing citizen-oriented public administration. Main problems in Croatian public administration such as excessive centralization in decision-making, politicization, lack of strategic and proactive approach persisted and continued to pose a burden on modernization efforts (Koprić, 2016; 2017b)<sup>2</sup>. Only period of public administration development that was strategically framed was between 2008 and 2011 when Strategy for State Administration Reform for the period 2008-2011 was in place. Still, political actors leading the reform process exhibited great reluctance to large structural changes and innovation leading to lukewarm

<sup>1</sup> To a certain extent, strategic approach was present even before. During the period 2008-2011 *Strategy for State administration reform* was in place, but omitted from its scope vital parts of public administration: local and regional government, services of general interest and even national agencies and other bodies at arm's length from the state administration core.

<sup>2</sup> A common classification of the problems in Croatian public administration distinguishes four groups: orientation problems, organization problems, motivation problems and implementation problems (Koprić, 2011; 2017b).

results and outcomes. The adoption of the Strategy in 2015 coincided with the end of six-year long economic and financial recession (2009-2014). After six years of GDP decline, recovery of Croatian economy started in 2015. Years of austerity created favourable climate for public administration reform, although the mainstream discourse developed a simplistic and reduced narrative about imperative changes in public administration. It advocated for ‘rationalization’ of public administration, meaning the reduction of public expenditure, ‘rationalization’ of number of civil servants and the abolishment of administrative bodies as well as local government units that were ‘unsustainable’ (Koprić et. al., 2018). This discourse was embraced by the general public, the media and some of the new and growing political actors. These considerations were not without merit – public administration did continue to expand during austerity years and predominantly did not share consequences of the economic crisis with private sector – loss of jobs, liquidation of companies and reduction of revenue. The left-centre coalition Government led by Zoran Milanović as Prime Minister (2011-2015) was rather passive and reluctant to launch comprehensive reform of public administration despite favourable circumstances. During the term, no significant reforms of public sector were implemented, despite the proclamations in Government’s Program which advocated for decentralization, territorial reorganization and other systemic changes. The Strategy was passed only at the end of Government’s term, several months before parliamentary elections. The core of the Strategy was drafted in a non-transparent manner by the Ministry of public administration (hereinafter: MoPA) and without official participation of external experts and other stakeholders. Only in final stages of its preparation the process was opened to the participation of external stakeholders from academia and civic society and put to public consultation. The Strategy was not adopted unanimously in the Parliament, as political consensus between parliamentary parties could not be reached<sup>3</sup>. Croatian accession to European Union in July of 2013 opened additional possibilities for the development of modern public administration through the support of ESI funds and the assistance in know-how. Even as a member, Croatia remained under the rigorous scrutiny of European Commission in the process of European Semester. In its 2014 report, European Commission noticed and warned that “quality of public governance in Croatia remains low” citing inadequate capacity to implement sound policies, high turnover rates in civil service and administrative fragmentation as main causes for such a state. These exogenous drivers, both possibilities of attracting additional resources as well as pressures from EC supervisors are explicitly referred to in the Strategy as important factors of its adoption. Strategy served the purpose of fulfilling the ex-ante conditions for the use of resources under ESF Operational Programme Efficient Human Resources, Priority Axis 4 – Good governance and of embedding the development of Croatian public administration within the wider strategic framework of Europe 2020 (Strategija, 2015, p. 2).

### **3. STRATEGY FOR PUBLIC ADMINISTRATION DEVELOPMENT 2015-2020**

#### **3.1. The structure and the objectives of the Strategy**

The Strategy is a sizeable and a robust document, 74-pages long. It contains a comprehensive and general analytical introduction and specific analytical frameworks for each of the three main areas of the reform, describing state of the art in Croatian public administration and identifying its main problems. In fact, analytical and descriptive sections of the document occupy 50 pages, while only 24 remaining pages contain specific objectives, measures and implementing activities. The title of the Strategy accentuated ‘development’, rather than ‘reform’, pointing out to the continuity of changes that begun before and avoiding implications of radical overhauls that could have been implied by the term ‘reform’. Main purpose of the Strategy is “to secure prompt, reliable and quality public services to the citizens in order to create high standards of living and enabling entrepreneurial environment” and is directed at the

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<sup>3</sup> The Strategy was passed by the majority of 80 out of 151 members of Parliament ([www.sabor.hr](http://www.sabor.hr)).

“enhancement of administrative capacities and better organization of public administration”. General purposes are elaborated in following goals: enhancement of efficiency and efficacy in public administration system, improvement of public services’ quality, the increase of mutual trust in communication between administration and citizens, increase of openness, transparency and accessibility of public bodies, strengthening the rule of law and social inclusion, inclusion of Croatian public administration in European administrative space and greater participation of users in public governance and the rise of democratic standards in political culture (Strategija, 2015, p. 2-5). The Strategy indicates three main areas of the reform: 1. Provision of public services; 2. Human resources in public administration and 3. System of public administration. They accurately reflect main organizational dimensions of public administration – processes, people and structures. Fourth part of the Strategy contains provisions for its implementation, coordination and monitoring. There are five specific objectives in the first area, elaborated into 17 measures that contain 96 implementing activities:

1. To improve procedures in public administration (eight measures, 45 implementing activities)
2. To facilitate communication between the users and public organizations (four measures, 24 implementing activities)
3. To increase the availability of public information (one measure, seven implementing activities)
4. To rationalize utilization of ICT resources (three measures, 13 implementing activities)
5. To improve the quality of public services (one measure, seven implementing activities)

Second area of the Strategy contains eight specific objectives, 14 measures and 62 implementing activities and is structured as follows:

1. To establish competence system (one measure, four implementing activities)
2. To improve the system of professional training in civil service (three measures, 18 implementing activities)
3. Efficient and transparent recruitment system (one measure, five implementing activities)
4. To establish career development system in public administration (three measures, 10 implementing activities)
5. To harmonize remuneration in public administration (one measure, five implementing activities)
6. To optimize the number of civil servants (one measure, four implementing activities)
7. To improve ethical standards in public administration (two measures, 10 implementing activities)
8. To establish a system of higher education for public administration (two measures, six implementing activities)

There are four specific objectives, 11 measures and 42 implementing activities within the third area of the Strategy which are structured as follows:

1. To rationalize administrative system (five measures, 18 implementing activities)
2. To foster the inclusion of Croatian public administration in European administrative space (two measures, five implementing activities)
3. To improve the coordination in public administration functioning (two measures, eight implementing activities)
4. To rationalize the system of local and regional self-government (two measures, 11 implementing activities)

Final part of the Strategy (specific objectives 18-20) is dedicated to the establishment of implementing, coordinating, monitoring and evaluative procedures and institutions.

Prime Minister's Office is identified as the chief governing body (owner) of the whole process and the main monitoring institution. It is an evident intention to position public administration reform as an important horizontal policy; a position that previous efforts were lacking. Task of political coordination was to be entrusted to the Government's Coordination for public policies and strategic planning which was yet to be established. Political oversight of the implementation process by the Government and Parliament is done on the basis of annual reports. The Strategy stipulates the drafting of several documents as implementing tools such as framework for implementation and monitoring, guidelines for information collection and storage as well as two successive Action plans for three-year periods.

### 3.2. Critical assessment of the Strategy

Although the content of the Strategy is not main subject of this paper, it is inevitable to analyse it because many shortcomings in the implementation process have their origin in the Strategy itself. Substantive and temporal scope of the Strategy makes it the most comprehensive document for public administration reform ever developed in Croatia. Still, it does not cover the whole public administration, because it does not include services of general interest, which are, at least in Croatian tradition, the vital part of public administration system. Also, reform objectives and implementing activities regarding local government, while present, are not sufficiently elaborated nor emphasized. Nevertheless, the Strategy has several strong points: a) its analytical framework appropriately addresses main problems and challenges in a precise and professional manner; b) systematization of reform objectives and measures is sound and correct. For the most part, Strategy followed guidelines and principles that SIGMA established for public administration reform regarding its strategic foundation (Sigma, 2014)<sup>4</sup>. Document as a whole reflects moderate and mixed value orientation – it is mostly founded on good governance principles and modernization agenda of public administration, in accordance with the principles developed within the European administrative space. Still, discourse that was developed during austerity years is echoed in the formulation of several objectives that require ‘rationalization’ of public administration and reflects the ‘minimization’ agenda of new public management approach. This approach was additionally fuelled by recommendations of European Commission. At the same time, the scope and the ambition of the Strategy poses several problems that affect its successful implementation. Multitude of measures reflects the lack of focus. It seems that every conceivable problem in Croatian public administration was deemed important enough to be addressed in the Strategy. Some of the proposed measures are real reforms, but many other are minor improvements and smaller adaptations in day-to-day work of public administration<sup>5</sup>. Although both kinds of measures could contribute to the overall administrative development, Strategy should have been more focused in favour of deeper structural changes and omit those that would have probably been achieved *via* regular activities. The sheer number of objectives, measures and implementing activities pose a great challenge for coordination and sequencing of the interdependent activities. Furthermore; there are many activities that don't have the effect of change – many of them represent only preparatory and analytical tasks that serve as a foundation to the actual reform activities. These should have been left out in order to show dedication to the end results and outcomes.

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<sup>4</sup> The existence of strategic framework for public administration reform is the first principle in Sigma's document that includes following components: a) The Government has developed and enacted an effective public administration reform agenda which addresses key challenges; b) Public administration reform is purposefully implemented; reform outcome targets are set and regularly monitored; c) Financial sustainability of public administration reform is ensured; d) Public administration reform has robust and functioning coordination structures at both the political and administrative level to steer and manage the reform design and implementation process; e) One leading institution has responsibility and capacity to manage the reform process; involved institutions have clear accountability and reform implementation capacity (Sigma, 2014, p. 9-17).

<sup>5</sup> Not every change in public administration can be labelled as a reform: „only deeper administrative changes that bring about more significant institutional innovation into the administrative system of a country may be called reforms“ (Koprić, 2017a, p. 36).

Majority of measures are only formally and broadly shaped and without specific content of its effects, outputs and outcomes. The Strategy in general lacks clear commitment to the specific results and concrete outputs. Its substantial vagueness could endanger its evaluation and allow for manipulation in official evaluations and reports. Also, there is no clear hierarchy of the objectives and measures. The Strategy doesn't distinguish priorities from other objectives and every intervention is formally of equal importance. Finally, Strategy failed to establish firm platforms and clear responsibilities for administrative and political coordination during the implementation process. Although the cooperation among different sectors and central bodies is implied by the simultaneous assignments of the same tasks, no cooperative structures on administrative level were envisaged. Various bodies were determined as responsible for different parts of the Strategy and in several cases all central administrative bodies are indicated as responsible. This dispersion of responsibility, together with lack of firm coordinating structures present a great obstacle for the effective implementation of the proclaimed goals and for the coherence of interdependent activities.

#### **4. IMPLEMENTATION PROCESS: OUTCOMES AND SHORTCOMINGS**

##### **4.1. Developments in political arena**

Developments in political sphere have not been supportive nor favourable to the implementation of the Strategy in past three years. Rather turbulent period brought several novelties to Croatian practice of democracy: the rise of new political forces in Parliament, the appointment of non-partisan Prime Minister, self-dissolution of the Parliament followed by extraordinary parliamentary elections in 2016 as well as personal and partisan reshufflings within the Government during the current term. Each of those events had a direct (negative) impact on Strategy implementation which had to be restarted several times in a short period of time, each time with new actors in charge. Elections of 2015 brought a new political force to the parliamentary arena – ‘The Bridge of Independent Lists’ (Most nezavisnih lista), a fresh and reform-oriented political platform comprised of local government mayors not affiliated to any major party and some notable academics. Since parliamentary majority could not be formed without their MPs, they conditioned their participation with independent (non-partisan) Prime Minister. After several months of negotiations, new government was formed by Croatian Democratic Community (Hrvatska demokratska zajednica – HDZ), a right-centre party and The Bridge while Tihomir Orešković, a less-known but successful businessman from pharmaceutical industry, was appointed as Prime Minister. Implementation of the Strategy became uncertain as Government was formed by the parties that voted against it (HDZ) or were absent from the Parliament at that time (Most)<sup>6</sup>. Newly appointed Minister of public administration Dubravka Jurlina Alibegović, an independent expert and scholar, took a proactive approach to the public administration reform, but, regardless of the Strategy and without much reference to it, reduced the number of objectives and measures and established quite different and decentralized implementing and managing structure which was very short-lived<sup>7</sup>. Croatia entered a period of political instability – continuous disagreements between the partners in ruling coalition eventually provoked the vote of no-confidence to the Government in Parliament and shortly after the self-dissolution of the Parliament itself. Extraordinary elections followed in September of 2016.

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<sup>6</sup> HDZ's campaign program in 2016, as well as the official Government's program (2016-2020), although quite extensive, completely ignored the Strategy and did not have a single reference to it, although they contained several indications about public administration reform.

<sup>7</sup> Government's Decision on Implementation of Reform Measures for Improving System of Public Administration was adopted at the beginning of 2016. It overshadowed the Action plan that was adopted by the previous Government in September of 2015. It established three main goals of PA reform and established three different commissions for their achievement and coordination: a) commission for modernization of public administration system; b) commission for development of human resources in public administration and c) commission for improving ICT support to public administration. As only the first one was presided and administered by the MoPA officials, Ministry lost its leading position in public administration reform process.

These events postponed and endangered the whole process of administrative reform. New Government, quite surprisingly, was formed by the same two parties in October of 2016. The adoption of the Action plan for Strategy implementation for the period 2017-2020 (hereinafter: AP) by the Government in December of 2016 re-established public administration reform agenda within the framework of the Strategy. Ministry of Public Administration was confided to the reform-oriented junior partner and the minister of public administration Ivan Kovačić took the position of Vice-president of the Government. Action plan narrowed the implementation time frame of the Strategy to only four years. Coalition between HDZ and the Bridge collapsed once again in April of 2017 and the Government was reshuffled as Croatian people's party (Hrvatska narodna stranka – HNS) replaced the Bridge as a junior partner, while HDZ took over the MoPA.

#### **4.2. Governance of Strategy implementation**

Although the Action Plan was envisaged as an implementing document, because of the external circumstances surrounding Strategy adoption and implementation, in reality it became a substitute for the Strategy itself providing a chance for the new Government to improve strategic framework for public administration reform and to acquire the ownership of the whole process. It basically mirrored goals, objectives and implementing activities of the Strategy, being similar in volume and in number of main objectives. It reshaped main areas of the reform into priorities, specifying their content and inverting their sequence, rightfully recognizing the primacy of structural reforms<sup>8</sup>. Formal position of Prime Minister's Office as a leading institution in the process of Strategy implementation, coordination and monitoring was never established which harmed the horizontal and systemic nature of public administration reform. This idea was even formally abandoned in the AP and the leading institution was proclaimed to be Government's coordination for public administration and judiciary system<sup>9</sup>. Ministry of public administration re-acquired its leading position as a main coordinator and facilitator of the implementation process. Following the provisions of the Action plan, and in similar fashion to the previous effort, Government established three different commissions for AP implementation, reflecting three priorities and presided by the officials of MoPA, other members being representatives of key line ministries and of other bodies responsible for the implementation of certain measures. Furthermore, a separate organizational unit was established within the MoPA with the task of coordinating, monitoring and facilitating reform implementation at the operational level, as well as administering the work of the commissions (Department for public administration development and EU programs). Action plan established a governance structure which was very dependent on the position of the minister of public administration as the vice-president of the government at that time. Government's coordination for public administration and judiciary which was governed by the minister of PA ceased to exist after the Bridge left the Government. Political coordination wasn't taken over by any other political body. AP foresaw the establishment of independent and professional advisory body 'Council for public administration reform' which would include prominent experts from academia and representatives of social partners, local government associations and non-governmental sector but it was never formed. Without such a body, openness of the whole process to the society and its participatory nature is at risk.

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<sup>8</sup> Action Plan contains three main priorities, seven general objectives and 21 specific objectives: 1. Development of efficient public administration (three general and eight specific objectives), 2. Depoliticisation and efficient human resource management in public sector (two general and eight specific objectives), 3. Informatisation of public services (two general and two specific objectives). Three remaining specific objectives are dedicated to the management of the implementation process, reporting and monitoring.

<sup>9</sup> Governmental coordinations are not suitable institutions for the governance of long-term and horizontal strategic documents. They are political inter-sectoral bodies whose main function is harmonization of political views on the acts that are already in procedure for the sessions of the Government.

Political monitoring of the implementation process was based regular reporting to the Government (semi-annual reports) and the Parliament (annual reports) by the MoPA but this practice has not been established yet. Not only it complicates political coordination and governance, but it also hinders the transparency of the reform as official data and results of the implementation are not systematically traceable. Action plan indicated financial scheme of the reform implementation by listing 24 projects that would be developed and financed mostly through European Social Fund. Overall financial value of AP implementation is HRK 894 million, out of which 760 is expected to be financed by the EU financial assistance. Largest allocations are assigned to the projects dealing with the establishment of administrative one stop-shops (HRK 114 million), the establishment of shared services centre (HRK 300 million) which is aimed at unification of state ICT infrastructure and to the improvement of the human resources management system (HRK 204 million).

#### **4.3. Assessment of the implementation results and outcomes**

As Action Plan from 2016 completely overshadowed the Strategy in public and political discourse, the assessment of Strategy implementation has to be substituted by the assessment of the Action Plan implementation outcomes. Dates were prolonged for the most of measures and implementing activities. Still, there are serious delays in every area of the reform. According to the AP, mid 2018 was due term for reaching following important objectives in reshaping the structure of public administration system: new regulatory framework for state administration, delegation of administrative competencies from ministries to territorial branches and public agencies, development of decentralization framework and the proposal for local government territorial consolidation. Organizational reforms that have been announced as a number one priority in the AP have not been implemented yet. Being perhaps the most politically sensitive area of the reform, they need the strongest possible devotion, guidance and consensus. General legal framework for public agencies has not been established, although there are sporadic reshufflings in that area, mainly aimed at the abolishment of some minor agencies<sup>10</sup>. In its annual Plan of legislative activity for 2018, the Government has announced this act to be adopted during the first quarter of the year, but no such act was passed and is not in sight. Also, framework legislation on state administration, which was due in 2017 was announced to be passed in the first half of 2018 but no proposal has been put to legislative procedure. Fragmentation of territorial branches of state administration has not been addressed yet. On the contrary, 21 new branch offices were established by the Ministry of Croatian veterans in 2017 and none other was abolished. Structural and functional reforms in local and regional government sphere are completely neglected. The public discussion about territorial restructuring at both local and regional level reached its pinnacle in 2017 and has been fading away since from media attention and political discourse. As if economic recovery and budgetary surplus covered all negative consequences of irrationally organized local government system. Only intervention in local government was political in nature and quite opposite to the objectives of the Strategy. The position and the competences of local mayors were strengthened at the expense of local council. This novelty have been heavily criticized from experts and academics in this field on the basis of its deviations from democratic standards. Other changes in local government system are not in sight. There is a certain progress in the field of strategic planning. At the end of 2017, a new piece of legislation was passed: ‘The Law on strategic planning system and development management’ which established a uniform framework for strategic planning for all public entities and territorial levels. It is yet to be seen how this

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<sup>10</sup> In past few years, several public agencies were abolished and/or merged with other similar bodies or with state administration. The most recent National Reform Program deviates from the sequencing established by the Action Plan and previous NRP and advocates the opposite: general legal framework would be drafted only after reduction of the number of the agencies and similar organizations at arms length from state administration (NRP, 2018, p. 38). This implies that some of the agencies will be abolished without clear legal criteria for doing so.

framework will be applied in future strategic documents and public policies. Reforms in civil service system have barely started. The attention has been devoted mostly to the salary system: harmonization of salaries across the whole system of public administration and the introduction of performance-related pay are main concerns in this area. Necessary prerequisites and intertwined measures for establishing a harmonized and stimulating salary system such as development of modern competence framework, the establishment of modern university education in public administration field or development of efficient in-services training programmes, although present in the Action Plan and logically related to the salary system, have been disregarded and ignored in official agenda. Other components of human resources system reforms are not in sight nor announced. Civil service legislative framework was slightly amended in 2017, but these changes constitute only minor improvements and were not part of wider strategic approach (see footnote 12). Action plan from 2016 emphasized one dimension of public services provision – their informatization and digitalization. The accomplishment of the objectives in this area is additionally supported by the Strategy e-Croatia 2020 which was adopted by the Government in 2017 and by the establishment of State office for the development of digital society in 2016 as a separate body in state administration system. A major step forward in digitalization of public administration services has already been made in 2012 when ‘e-citizen’ service system was introduced. It has been continuously upgraded with additional e-services. As of 2017, 43 different digital services have been developed and made available to the citizens. Unfortunately, the number of users has been increasing very slowly – approximately half million of the citizens are registered users as of now. Despite obvious progress in this area of the reform, it seems that overlapping in functions and roles among MoPA, the aforementioned State office and the state-owned company APIS IT<sup>11</sup> slow down the process. There are serious laggings in establishing Centre for shared services, a consolidated system of national information infrastructure and in development of standardized ICT solutions that would ensure inter-operability of all public bodies, although the legal framework is in place. Also, e-business service system, which would facilitate the provision of administrative services to businesses in a similar manner to the e-citizen system, has not been established yet, although it had been announced for 2017. Since October of 2017, all public bodies are provided with an access to electronic databases of civic registers and are obliged to access them ex officio in all dealings with citizens. More and more public registers are made available to public which constitutes another element of the progress in this area. Many important reform objectives and measures from the Strategy and the Action Plan have been repeatedly included in other policy documents, most important being National Reform Programmes (NRPs) only to be continually evaluated as insufficiently implemented by the European Commission in its annual reports. Rationalization and the establishment of general legal framework for public agencies, consolidation of territorial branches of state administration, revision and harmonization of salary systems in civil service are objectives that have been part of each NRP since 2015 (NRP, 2015; 2016b, 2017; 2018). Year after year, the assessments of European Commission have been rather negative and disappointing: ...” progress is slow” (EC, 2015, p. 49), “progress in carrying out reform agenda in public administration remains uncertain” (EC, 2016, p. 74), “no concrete progress in tackling the weaknesses in public administration” (EC, 2017, p. 50), “major reforms in public administration have not considerably advanced” as “there is no firm political commitment” (EC, 2018, p. 47). Expectedly, the aforementioned objectives were included once again in the newest National Reform Programme for 2018 as well as the Government’s annual legislative plan and are due during this year. Although the absorption of EU funds was main driver for the strategic approach to public administration reform, there are delays in project development and implementation. Only several projects have been fully prepared and initiated, but none of them is fully executed.

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<sup>11</sup> Agency for the support to information systems and technology LLC.



Lack of qualified civil servants in this area presents as almost insurmountable obstacle in effective project design and implementation<sup>12</sup>. Nevertheless, the project ‘mantra’ tend to overshadow the actual accomplishment of reform objectives – the amount of EU financial assistance that is absorbed is politically more attractive than the real outcomes.

## 5. CONCLUSION

Is there a process of public administration reform in Croatia at all? Are these sporadic and rare, delayed and usually externally forced interventions across the public administration interconnected and sequenced enough to constitute a unitary process that is purposefully and unilaterally managed? These, largely rhetorical questions, indicate true state of Strategy implementation three years after its adoption. The ‘process’ is most definitely not governed by the Strategy which is another confirmation of Croatian tradition of non-implementation of strategic documents. Institutional capacity in Croatian public sphere is far from being sufficient to implement pro-active, long-termed and strategically framed policies, let alone systemic reforms. As a consequence of the MoPA’s leading position, public administration development process is usually perceived as (just another) sectoral reform. This perception harms its horizontal and systemic importance and makes the whole process highly dependent on MoPA’s rather weak organizational capacities. The fact that every strategic document has to design specific governance structures for its implementation indicates the lack of firm institutions for policy coordination in Croatian politico-administrative system. This reform missed an opportunity to address such a challenge and to establish adequate and permanent structures within the centre of Government, able to tackle any bigger strategic challenge and implementation process and to provide strong leadership. The dominance of politics over administration, which is reflected in strong dependence of Strategy implementation on recent events in political sphere, causes discontinuity of public administration reform process. A strong and professionally equipped leading institution at the centre of the Government could, at least partially, overcome and hopefully annul this dependence and its negative effects. It seems that administrative reform as a singular policy lost its momentum as debates and public discussions faded. This is especially the case with local government whose importance is regularly overshadowed by other reform issues. Incorporated within the public administration strategic framework, local government is being reduced to its administrative role and is presented as just another administrative level. In order to highlight its political and economic (developmental) role and its overall importance and to boost a wide and professional public discussion about decentralization reforms, local government reform should be framed in separate strategic document. Current political situation doesn’t allow for optimism in near future. Superficial understanding of reform objectives by politicians, instable political leadership and thin parliamentary majority, where only 77/151 members of Parliament support the Government, are never suitable nor promising circumstances for radical changes. Despite the declaratory political support, it seems inevitable that the reform process of public administration in Croatia will remain on the path of inertia and hesitant development with small and sporadic changes that will happen as a reaction to external, mostly financial incentives or conditionality policies from influential international actors (Koprić, 2017b, p. 379). As a rule, most components of the reform are insufficiently communicated to the public. Non-existent reporting towards Government and the Parliament makes examination and the evaluation of the activities from the outside almost impossible. Traditionally strict normative approach in Croatian public sphere preserves public consultations only for situations when a formal act (legislative proposal) is drafted.

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<sup>12</sup> This problem was addressed in recent amendments of Civil Service Law in 2017 which simplified the recruitment procedure in civil service in general and allowed for the longer duration of fixed-term contracts for civil servants dealing with ESI funds management tasks.

Measures that are not embodied in legal acts or in more significant structural changes are not visible to the wider audience. Croatian Parliament should regain authority and ownership of the process by establishing a specialized committee for regular political monitoring of the Strategy implementation. It is necessary to strengthen the participatory and cooperative nature and openness of the process. The inclusion of domestic experts and social partners in advisory capacity would not only contribute to the quality of reform outputs by ensuring evidence-based policy inputs, but would also significantly increase the legitimacy of the whole process. Finally, only appropriately educated, motivated and stimulated civil servants can guarantee long-term sustainability of any reform efforts. They would have a natural inclination towards continuous improvement in public administration as the opposite of being resistant to it and would act as an endogenous factor of change. The more a reform agenda is advocated from within the system, the greater is a chance for success – external pressures, especially from domestic actors are easily ignored. These are the reasons for the establishment of adequate educational programmes and university degrees for civil servants and the objective and transparent system of recruitment and promotion for the whole public administration. Only after these foundations are in place, salary component of civil service can be discussed and adjusted to the requirements of modern human resources management in public administration. These reasons, as well as the need for greater continuity in policy making and implementation, advocate for further professionalization and depoliticization of high administrative officials (i. e. assistant ministers), a task that was announced but largely neglected.

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## **CERTAIN LEGAL ASPECTS OF EFFICIENT USE OF WATER RESOURCES IN THE PRACTICE OF THE EUROPEAN COURT OF HUMAN RIGHTS**

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### **ABSTRACT**

*The broadest document in the area of water protection, as one of the basic living resources, refers to the solutions provided by Directive 2000/60/EC on the establishment of a framework for Community action in the field of water policy and by Directive 2013/39/EC amending Directive 2000/60/EC. The most important document of the European Union with regard to sustainable water management is Directive 2000/60/EC. By prescribing the aims at maintaining and improving the aquatic environment and the sustainable water use based on a long-term protection of available water resources, Directive 2000/60/EC establishes strategies against water pollution. Among the most significant provisions of Directive 2000/60/EC, are provisions which determine water prices as a measure designed to incentivize users to use water resources efficiently. To this end, the author analyzes the relevant provisions of Directive 2000/60/EC by providing interpretation of its provisions by the European Court of Human Rights.*

**Keywords:** *European Court of Human Right, legal aspects, water resources*

### **1. INTRODUCTION**

Charter of Fundamental Rights of the European Union (EU Charter) (SL 2007 / C 303/01) stipulates that everyone has the right to life (Article 2) and that human dignity is inviolable and must be respected and protected. (Article 1). Those rights can also be interpreted as being of direct relevance for access to safe drinking water and improved sanitation. (Communication from the Commission on the European Citizens' Initiative: "Water and sanitation are a human right! Water is a public good, not a commodity!", 2014, notes on the current state) The right to clean and safe drinking water is also confirmed at the United Nations (UN) level with the UN General Assembly Resolution which recognizes the right to safe and clean drinking water and sanitation as a human right of crucial importance for full enjoyment of life and all human rights". (UN General Assembly Resolution of 28 June 2010, No. 64/292, 'The Human Right to Water and Sanitation', p.2) The European Union has also confirmed that "all States bear human rights obligations regarding access to safe drinking water, which must be available, physically accessible and affordable". (Statement by High Representative Catherine Ashton on behalf of the EU to commemorate World Water Day, 22nd March, 2010, p.1.) It was found that every 20 seconds anywhere in the world, a child dies from the consequences of infectious diseases related to the pollution and availability of drinking water or lack of hygiene. (Statement by High Representative Catherine Ashton on behalf of the EU to commemorate World Water Day, 22nd March, 2010, p. 2). Pollution refers to any physical, chemical or biological change in the composition or quality of water that is directly or indirectly a consequence of human activity, disables legitimate use of water and causes damage (Degan V. Đ., 2006., p. 419.). At the UN World Conference on the Human Environment, held in Stockholm in June 1972, the Declaration of UN Conference on the Human Environment was adopted, and among its principles prescribes that natural resources of the earth, including water, must be safeguarded for the benefit of present and future generations. (Principle No. 2, Stockholm Declaration, <http://www.un-documents.net/aconf48-14r1.pdf>) In 1992, the UN Conference on Environment and Development was held in Rio de Janeiro, where the Rio Declaration on environment and

development was adopted, defining one of the basic principles of environmental protection - 'polluter pays' - meaning that the polluter should bear the cost of pollution with due regard to the public interest. (Principle No. 16. Declarations from Rio, <http://www.un.org/documents/ga/conf151/aconf15126-1annex1.htm>). The polluter may be any natural or legal person who through direct or indirect behavior or omission causes environmental contamination. (Drmić A., 2012, p. 868) The principle of 'polluter pays' is an integral part of Directive 2004/35/EC of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage. (Ohliger T., 2018, p. 2) The preamble of Directive 2004/35/EC states that the fundamental principle should be that an operator whose activity has caused environmental damage or an imminent threat of such damage is to be held financially liable, in order to induce operators to adopt measures and develop practices to minimize the risks of environmental damage so that their exposure to financial liabilities is reduced (Point No. 2., Directive 2004/35/EC).

## **2. EUROPEAN SOLUTIONS IN THE AREA OF WATER PROTECTION**

### **2.1. The process of adopting Directive 2000/60/EC of the European Parliament and of the Council on establishing a framework for Community action in the field of water policy**

After the first UN Conference on the Environment in 1972, a European Council meeting was held in Paris, where the Heads of State (or Government) declared the need to create an environmental policy at European Community level. (Ohliger T., 2018, p.1) Single European Act from 1987 introduced the new 'Environment title', which provided the first legal basis for a common environment protection policy and ensuring rational use of natural resources. (Ohliger T., 2018, p.1). Treaty on the Functioning of the European Union (TFEU) (OJ EU 83/1) in Articles 191 to 193 states that EU environmental policy contributes to the preservation and improvement of environmental quality, to the protection of human health, rational utilization of natural resources and the promotion of measures to deal with regional or worldwide environmental problems. The TFEU, also provides that the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee and the Committee of the Regions, shall decide what action is to be taken in order to achieve these objectives (Article 192). In 1998, Community Water Policy Ministerial Seminar was held in Frankfurt, highlighting the need for Community legislation covering ecological quality. The Council of the European Union (Council) in its Resolution (June 1998) invited the European Commission (Commission) to submit, as soon as possible, appropriate proposals to improve the ecological quality of the surface waters of the Community. (Council Resolution, OJ EU 88C 209/02, 9.8.1988, p. 3) In The Declaration of Ministerial Seminar on groundwater held at The Hague, the need for action to avoid long-term deterioration of water quality and quantity was recognized and called for a programme of actions to be implemented by the year 2000 aiming at sustainable management and the protection of freshwater resources. (Directive 2000/60/EC, Point 3.) In its Annual Report "Environment in the European Union" (1995.), European Environment Agency presented an updated state of the environment report, confirming the need for action to protect Community waters in qualitative as well as in quantitative terms. (EEA Annual Report, 1995) In 1996, the Council, the Committee of the Regions, the Economic and Social Committee and the European Parliament all requested the Commission to come forward with a proposal for a Council Directive establishing a framework for a European water policy. (Point 10., Directive 2000/60/EC) Finally, on October 23<sup>rd</sup> 2000, the European Parliament and the Council of the European Union adopted Directive 2000/60/EC establishing a framework for Community action in the field of water policy.

Directive 2000/60/EC was published in the Official Journal of the European Union on December 22<sup>nd</sup> 2000, when it came into force, and until now it is the broadest document in the area of water protection. With The Directive 2008/32/EC of the European Parliament and of the Council of 11 March 2008, Directive 2000/60/EC was amended as regards the implementing powers conferred on the Commission. The Directive 2000/60/EC was re-amended on August 12<sup>th</sup> 2013 by Directive 2013/39/EC of the European Parliament and of the Council as regards the determination of priority substances among those which pose a significant risk to the aquatic environment. (Directive 2013/39/EC, Point 4.)

## **2.2. Objectives and purpose of Directive 2000/60/EC**

According to the introductory provision of Directive 2000/60/EC (Directive), water is not like any other commercial product, but it is heritage which must be protected, defended and treated as such. The provisions should also contribute to the progressive reduction of emission of hazardous substances to water because good water quality will secure drinking water supply for the population. The purpose of the Directive is to maintain and improve the aquatic environment in the Community, which primarily relates to the quality of waters, which in turn will contribute to and ensure the supply of drinking water to the population. (Directive, Point 19.) It is also important to ensure full application and implementation of existing environmental legislation for the protection of waters and proper application of the provisions implementing this Directive throughout the Community with appropriate penalties provided for in Member States' legislation. (Directive, Point 53.) According to article 1, the purpose of the Directive is to establish a framework for the protection of inland surface waters, transitional waters, coastal waters and groundwater which prevents further deterioration and protects the status of aquatic ecosystems (and terrestrial and wetland ecosystems). The Directive also promotes sustainable water use based on long-term protection of available water resources, aims at better protection and improvement of the aquatic environment, ensures the progressive reduction of pollution of groundwater, contributes to mitigating the effects of floods and droughts and thereby contributes to the provision and sufficient supplies of good quality surface as well as groundwater needed for sustainable water use. It also ensures reduced pollution of groundwater and the protection of territorial and marine waters. (Directive, Article 1) Definitions of important terms are listed in article 2 of the Directive. The expression 'surface waters' refers to inland waters, except for groundwater, transitional waters and coastal waters, except in respect of chemical status for which it shall also include territorial waters; 'groundwater' means all water which is below the surface of the ground in the saturation zone and in direct contact with the ground or subsoil, whereas 'transitional waters' are bodies of surface water in the vicinity of river mouths which are partly saline in character as a result of their proximity to coastal waters but which are substantially influenced by freshwater flows. Finally, the term 'inland water' means all standing or flowing water on the surface of the land, and all groundwater on the landward side of the baseline from which the breadth of territorial waters is measured. For the purposes of achieving the aims of the Directive, Member States may set the program of measures in stages in order to evenly spread the costs of implementation, but any extension of the deadlines must be based on transparent criteria. The Commission shall be assisted by a Regulatory committee (Committee). (Directive, Article 21) Member States have a time limit in which they are required to adopt laws and other provisions necessary to comply with this Directive.

## **3. RECOVERY OF COSTS FOR WATER SERVICES**

In Article 9, Directive stipulates that Member States shall take into account the principle of recovery of the cost of water services, including environmental costs and resource costs, particularly in accordance with the polluter pays principle.

Water services are defined as all services which provide storage and distribution of surface water or groundwater for households, public institutions or for any economic activity. These services also provide waste-water collection and treatment prior to its discharge into surface water. (Directive, Article 2, Point 38) According to article 9, Member States shall ensure that water price policies are an incentive for users to use water resources efficiently and thereby contribute to the achievement of the environmental objectives of this Directive. Furthermore, they are required to ensure the adequate contribution of various users (industry, agriculture, households) to recover the cost of water services, taking account of the polluter pays principle and basing their actions on the economic analysis. Directions for the implementation of the economic analysis are set out in Annex III, which states that the economic analysis shall contain sufficient information to make relevant calculations which are necessary for the recovery of the costs of water services (estimates of volume, prices and costs associated with water services) and calculations of economically most cost-effective combination of measures in respect of water uses. Also, Member States shall not be in breach of this Directive if they do not apply provisions on the recovery of costs for water services if this does not compromise the purpose and the achievement of the objectives of this Directive (Article 9, Paragraph 4). In Case C-525/12, on 11 September 2014, the Commission asked the European Court of Human Rights (ECHR) to declare that the Federal Republic of Germany had failed to fulfill obligations under the Directive by excluding certain services from the concept of ‘water services’. The Federal Republic of Germany interpreted the term ‘water services’ as referring only to the supply of water and the collection and elimination of waste water, excluding services such as accumulation for purposes of hydroelectric power generation, navigation or flood protection. Consequently, such services were not included into the obligations under the Directive, and the principle of recovery of costs including environmental and resource costs was not applied to such services. The Federal Republic of Germany contended that the Commission's action was inadmissible because it asked a purely theoretical question and did not identify the specific behavior which should be solved. Further, the accused Member State argued that the lawsuit was not precise since the examples of water services were not specified so it would not be possible for the state to know whether other water services should be categorized in the same manner. ECHR concluded that measures for the recovery of costs for water services were one of the instruments available to Member States for qualitative management of water in order to achieve rational water use. Only from the fact that the Federal Republic of Germany did not apply this principle to some activities and in absence of any other ground for complaint, it could not be concluded that the Member State had failed to fulfill its obligations from the Directive and all this in accordance with the provision that it is possible not to apply the principle of recovery of costs for water services where this does not compromise the purpose and the achievement of the objectives of the Directive. In case C-686/15, The National Court of the Republic of Croatia in Velika Gorica requested a preliminary ruling of provisions of the Directive. The request was made in proceedings between Vodoopskrba i odvodnja d.o.o. (municipal water distribution services supplier for the area of a number of cities in Croatia) and Željka Klafurić, who disputed part of the amount of the invoices relating to the water service for the period between December 2013 and June 2014. Željka Klafurić disputed that she owed the fixed part of the price of water services that was calculated independently of the actual water consumption. The National Court asked whether EU citizens paid the invoices concerning their water consumption by paying only for the consumption actually shown on the meter or if they paid other fees and charges in addition. In other words, the National Court wanted to establish whether there was a breach of the Directive by a national law which provides that the price of water services invoiced to a consumer is to include not only a variable component calculated according to the volume of water actually consumed by the person concerned, but also a fixed component covering the charges for the connection of buildings to the water supply works,

reading and servicing the meter as well as analyzing the quality of drinking water. The ECHR concluded that Member States were obliged to ensure that water pricing policies provide adequate incentives for users to use water resources efficiently. The European Environment Agency's report, entitled 'Assessment of cost recovery through water pricing', shows that it is common practice in the Member States that the price of water services is composed of a fixed component and a variable component (European Environment Agency, Technical Report No. 16/2013, p. 50, 51). Therefore, ECHR concludes that the legislation of the Republic of Croatia is not in contradiction with the provisions of the Directive.

#### **4. ENVIRONMENTAL OBJECTIVES RELATED TO SURFACE WATERS**

Member States are obliged to implement necessary measures to prevent deterioration of the status of all bodies of surface waters, as well as all artificial and heavily modified water bodies, with the aim of achieving good ecological potential and good surface water chemical status. (Directive, Article 4) Member States are also obliged to protect, improve and restore all surface water bodies in order to achieve good surface water status at the latest 15 years after the date of entry into force of this Directive. (Article 4) Thus, this provision imposes two obligations - preventing deterioration of surface waters and improving surface water status, and both are aimed at achieving the goal of protecting the good ecological and chemical status of surface water. In general, surface water status is defined as an expression of the status of surface water body, determined by its ecological or chemical state. The Directive does not contain a precise definition of deterioration of surface water status. The issue of interpretation of the term 'deterioration of surface water status' was referred to by the Bundesverwaltungsgericht (Federal Administrative Court in the Federal Republic of Germany) in Case C-461/13 (analyzed below). The ECHR provides an interpretation that there is 'deterioration of the surface water status' as soon as the status of at least one of quality elements (defined in detail in Annex V of The Directive) falls by one class, even if that fall does not result in a fall in classification of surface water body as a whole, but if the quality element is already in the lowest class, any deterioration is considered to be deteriorating the quality of water. Temporary deterioration of the status of water status is not considered to be in breach of Directive's requirements if it is the result of circumstances of natural cause or force majeure which could not reasonably have been foreseen or because of extreme floods and prolonged droughts and if all conditions prescribed in Article 4, Paragraph 6 are fulfilled. In case C-641/13, The Bundesverwaltungsgericht (Germany) requested for a preliminary ruling of these provisions in the proceedings between the Bund für Umwelt und Naturschutz Deutschland eV (German federation for the environment and the conservation of nature) and the Bundesrepublik Deutschland concerning a scheme to deepen various parts of the river Weser in the North of Germany, intended to enable larger container vessels to come at the German ports of Bremerhaven, Brake and Bremen. The aim of the project was to increase the depth of the outer channel Waser so that big container ships could pass independently of the tide, while in Lower Waser the depth should be increased by up to 1 meter. The projects involved dredging the river and after that, regular dredging for maintenance purposes and the most of the dredged material arising from the development and maintenance of the river was purposed to be discharged into the outer and lower Waser at locations that had already been used for that purpose. According to the national court, the project at issue had other hydrological and morphological consequences, in particular tidal high water would rise, tidal low water would fall, salinity would increase, the brackish water limit would move upstream. The Bundesverwaltungsgericht (Federal Administrative Court) asked ECHR if the Member State must refuse to authorize a project if it may cause deterioration in the status of surface water body. The Directive provides that Member States shall implement the necessary measures to prevent deterioration of status of all bodies of surface waters and the words "shall implement" involve an obligation on the Member States to act to that effect.



The ECHR ruled that any deterioration of status of water bodies must be prevented, irrespective of longer term planning provided for by management plans and programs of measures and that the Member State must refuse authorization for the project where it may cause a deterioration of the status of a body of surface water or where it jeopardizes the achievement of good surface waters status (unless a derogation is granted).

## **5. PROGRAMME OF MEASURES WHICH MEMBER STATES SHALL ENSURE**

The Directive prescribes the obligation of Member States to adopt a programme of measures for each river basin district or for the part of an international river basin district within its territory. (Article 11) A programme of measures includes basic measures and supplementary measures which are implemented in addition to the basic measures. The basic measures are the minimum requirements and they are set out in Article 11 of the Directive. They consist of measures required to implement Community legislation for water protection, measures deemed appropriate for the purpose of the principle of recovery of costs for water services, measures to promote efficient and sustainable water use, measures to safeguard water quality (in order to reduce the level of purification treatment required for the production of drinking water), controls over the abstraction of fresh surface water and groundwater and impoundment of fresh surface water, prior regulation for point source discharges liable to cause pollution, measures to control or prevent the input of pollutants for diffuse sources liable to cause pollution, control of any other significant adverse impacts on the water status, prohibition of direct discharges of pollutants into groundwater, measures in accordance with the action based on the established water pollution strategy and all necessary measures required to prevent significant losses of pollutants from technical installations and to prevent or reduce the impact of accidental pollution incidents (floods or accidents which could not reasonably have been foreseen). Supplementary measures are listed in the Annex VI, but Member States may also adopt further measures in order to provide additional protection or achievement of the objectives set out in the Directive. For example, supplementary measures include abstraction controls, construction projects, development and demonstration projects, educational projects, rehabilitation projects. If the objectives set in the Directive are unlikely to be achieved, Member States are obliged to ensure that the causes of possible failure are investigated, examine relevant permits and authorizations, adjust the monitoring programs and to take additional measures to achieve these objectives. (Article 11, Paragraph 5) The directive has set strict deadlines for the establishment of measures and it is nine years after the entry into force of the Directive and all measures shall be operational at the latest twelve years after the entry into force of the Directive. All measures should be reviewed at the latest fifteen years after the date of entry into force of the Directive, and every six years thereafter (Article 11, Paragraph 7 and 8). Member States shall ensure the establishment of programmes for the monitoring of water status in order to establish a coherent and comprehensive overview of surface waters, groundwaters and protected areas. (Directive, Article 8) For surface waters such programmes cover volume and rate of flow to the extent relevant for ecological and chemical status and ecological potential; for groundwater the programmes cover monitoring of the chemical and quantitative status, while for protected areas such programmes shall be supplemented by those specifications contained in Community legislation under which the individual protected area has been established (Directive, Article 8). In Case C-648/13, on December 6th 2013, the Commission decided to institute a proceeding against the Republic of Poland asking the ECHR to declare that the Republic of Poland has failed to fulfill its obligations under the Directive. Firstly, on June 28<sup>th</sup> 2008, the Commission sent a letter of formal notice to the Republic of Poland in which they criticized the gaps in the national transposition measures of the Directive. Although, in the meantime, the Republic of Poland had introduced amendments to national laws, the Commission decided to institute the proceeding.

During the proceeding, the Commission stated that the Republic of Poland had not ensured complete and suitable transposition of the provisions of the Directive on monitoring the status of surface waters, groundwater and protected areas. The ECHR found that the provisions of the Republic of Poland's national law did not define the term 'environmental monitoring', nor did other provisions satisfy the requirements of the Directive, or guarantee that monitoring programs were established in accordance with the requirements of the Directive. Also, the ECHR found that even if the provisions of the national law which require that monitoring be introduced for protected areas in order to determine degrees of compliance with additional requirements were taken into account, the provision was not correctly transposed, because it failed to extend the monitoring parameters for protected areas to those set out in the Directive. Furthermore, the Commission states that the Republic of Poland did not correctly adopt the programme of measures provided for by the Directive. Although the national law of the Republic of Poland envisages “the development of the draft national programme for water and the environment”, it limits its scope to when the national programme for water and the environment has been drawn up, while the Directive envisages periodic testing as well as undertaking measures when there is even a small chance of achieving environmental goals. The Republic of Poland submits that these provisions should be transposed in the draft reform legislation for the Water Law and certain other laws. In this case the ECHR has declared that the Republic of Poland has failed to fulfill its obligations under provisions of the Directive.

## 6. CONCLUSION

In conclusion, it can be said that nowadays, more and more attention is being paid to the protection of water resources and environmental protection in general. Due to the exhaustion of the already weak water resources we can say that, in the future, the problem with water will be increasing. Although water quality is still good in most European Union countries, the question is how long it will remain so. Effective water management, as required by Directive 2000/60/EC, helps Member States prepare for extreme weather conditions that, due to climate change, become more and more frequent and cause enormous damage (Communication of the Commission of the European Parliament and the Council "Water Framework Directive and Floods Directive", 2015, Introduction). The first European Citizens' Initiative was 'Right2Water', which urged that the EU institutions and Member States are obliged to ensure that all inhabitants enjoy the right to water and sanitation, that water supply is not subject to internal market rules and that the EU should increase its efforts to achieve universal access to water and sanitation (Communication of the Commission on the European Civic Initiative "Water and drainage are human rights! Water is a public good, not stuff!", 2014, Introduction). The initiative was supported by 1.9 million citizens and it was the reason why the European Parliament adopted the Resolution on the follow-up to the European Citizens' Initiative Right to Water (2014/2239 (INI)) on September 8<sup>th</sup> 2015. (Resolution) The Resolution stresses the importance of water resources and concludes that at least 748 million people worldwide do not have access to safe drinking water, a third of the world's population has no basic sanitation, and a large number of children die daily due to water-borne diseases and inadequate water. (Resolution, Point F) It is also once again emphasized that the UN affirms the human right to water and gives everyone the right to safe, physically accessible and affordable, good quality water for personal and domestic uses. With this Resolution, the European Parliament calls on the Commission to come forward with legislative proposals in line with the primary objective of the 'Right2Water' Initiative and, if necessary, to make a revision of Directive 2000/60/EC in order to recognize the human right to water as well as to universal access to safe drinking water. (Resolution, The ECI as an instrument of participatory democracy) Furthermore, it calls on the Commission to inform and educate people in order to promote the culture of water as a common asset and to raise awareness of individuals in terms of water saving and rational consumption.

Lastly, the Resolution calls on Member States to ensure non-discrimination in access to water services, ensuring their provision to all, including marginalized user groups. To conclude, the European Parliament urges the Commission to ensure that quantitative assessments of water affordability problems become a mandatory requirement for Member States when reporting on the implementation of the Directive.

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## THE IMPORTANCE OF INFORMATION TECHNOLOGY EDUCATION FOR THE FUTURE

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### ABSTRACT

*Education is a central issue in the complex development process and it is associated with population growth, working skills, as well as cultural and infrastructural development in general. This paper shows some of the important dynamics of education and change in society. Some countries that have taken great steps to increase enrolment and which currently have disappointing results will surely benefit from it in the future. Education levels have a long-term impetus and the growth of adult education is non-linear. This is an important aspect in defining scenarios for future population growth. It is estimated that by 2020, 1.5 million new digitized jobs will be available worldwide. At the same time, some 90% of organizations currently lack IT skills and 75% of educators and students think there is a gap between their IT skills and job requirements. In order to provide the competence required for a digital economy, education needs to respond quickly to the needs for IT skills that are ever growing and developing. Personalized learning, experiential learning and skills-based learning is the future of educational systems in the world. This paper presents these very ideas and a possible future direction of education which combines artificial intelligence, information technology, and several new design paradigms that could change education forever.*

**Keywords:** *Information technology, IT education, personalized learning, STEM*

### 1. INTRODUCTION

Today's education system is static, general and less focuses on individual self-development than it should. To make things worse, students often do not understand why they learn things they learn, which makes certain classes arbitrary and meaningless in front of their personal ambitions (and also has several neurological consequences that will soon be discussed). In addition, what could be done to resolve these issues and take education to a whole new level? What could make education more exciting, funnier and more practical? We believe it comes down to three simple ideas (which are not new in any possible way) that can finally be fully explored by the clever use of technology. The quality of education is very important for the young because they are the ones that would lead the country forward. If the young do not get adequate education, we will fall behind other countries. Why is education so important? Its benefits are improving intelligence and better achievements of the young generation in order to increase their competitiveness in a turbulent global marketplace. The function of education is very clear. By improving education we will be able to strengthen the future of the nation. It is currently difficult to find a job. Candidates who do not have a good educational background are not competitive in the labour market. Higher education leads to higher income and higher standard of living. Thus, one can say that education is the key to the future.

Education is not just about preparing a graduate for their future job. Education trains our abilities and skills in problem solving and helping people to solve them in a quick and accurate manner. There is formal and informal education and both of them are very important. Many successful and educated people provide help for people without formal education. Someone with a good academic background can certainly become a mentor and a special person that others can rely on. In a given period of time, it is important to choose a field of study for an occupation that is lucrative and in shortage. For example, the skill that is difficult to master for many people is computer programming. Programmers are highly valued and after their formal education in programming they have a chance to get a high-paying job, and still have time for their family. When they start a course of programming, they can receive on-line help with their programming homework such as, for example, Java. It requires a lot of self-discipline and practice, but it is a skill that can be mastered over time. Research (The CEA, 2018) has shown that people with higher education qualifications earn about 25% more than those without education. People with professional degree usually have deeper knowledge of their field, plus the experience gained during their studies. This makes them more qualified for a higher rank. Some individuals think they do not need to continue their education, as all jobs will not require high qualifications. Although it is true at some levels, if somebody wants a better paying job, it is conditioned by the continuation of education. It is a known fact that individuals with a higher level of education earn more. According to the aforementioned study, an individual with a higher degree earns on average twice as much compared to someone without that degree. Of course, there are always some exceptions and there are individuals who do not have a college degree and still make a good living. However, these are rare cases. It is not unusual for a society to label the individual in terms of educational achievement. Although this is stereotyping, it is not necessarily good. However, when it comes to a conflict between what is ideal and what is real, reality wins every time. Maybe it will change in the future.

## **2. INFORMATION TECHNOLOGY AND EDUCATION**

New technologies such as AI<sup>1</sup>, machine learning, and educational software are not only changing the field of study, they also encourage the role of a teacher, create philosophical shifts in approaches to teaching, and redesign the classroom. The digital labour market is still evolving rapidly, and each year more qualified IT<sup>2</sup> professionals are in demand. Increasing demand for expertise and skills of computer programming has become the responsibility of a teacher, but not only in higher education. Primary schools and nurseries are a key factor for influencing the next generation of professionals by initiating earlier interest in a child for STEM fields. If a child can dream about walking on the Moon one day, why should not their imagination be open to becoming a computer wizard? For the industry that is growing and looking for graduate candidates, it is becoming increasingly difficult for employers to find them. Such growth, with the emergence of new technologies, has led to shortage of skills in key areas such as scripting language and cyber security. The Technical Partnership Council has found that in the third quarter of 2015 and the second quarter of 2016 in the UK there were 7,000 IT jobs advertised - 100% more than five years before. Information society is democratic and open, and all its citizens, without any exceptions, have the same opportunities and rights to seek, receive and transmit information and opinions of any kind, through any medium, without any restrictions. Information science has three basic characteristics: interdisciplinarity, inseparable connection with IT technologies (technical aspects), and active participation in construction of information society (social and human aspect). The emergence of the European dimensions of IT education in each country within the framework of the Information Society should bring it to the Society

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<sup>1</sup> Artificial Intelligence (AI) is one of the most important technologies in the modern world. It has wide influence and applications, eg. in medicine, stock market forecast, and art.

<sup>2</sup> Information Technology

of Knowledge while strictly preserving and respecting the autochthonous culture of self-awareness and diversity (Nadrljanski, M. et al., 2016, p. 90). Another problem with the current industrial climate is the ratio of male and female graduates. According to the WISE campaign, the STEM economy is crowded with men, while only 23% of the UK workforce is female. In search of change, advertisements were used to encourage women to work in the industry. However, a huge part of the problem arises with the choices of a child and influences they face in their early years. Early life experiences often shape future interests, which is why educators even in nurseries have to expand the horizons of young children and change the stigma around girls in technology by using fun and interesting learning tools. With an introduction of new learning models, traditional educational methods have to develop in the next decade. To get a better insight into where things are going, Business Insider<sup>3</sup> has taken a closer look at the role of development technology in education and emphasized the progress that could be identified for the future. Each student learns differently, and technology is here to allow educators to customize the unique learning style on case-by-case basis. Technologies such as DreamBox, math education software used in many classrooms throughout the USA, adapt to each student's level providing the fastest learning tailored to individual needs. Adaptive learning software quickly replaces textbooks in classrooms and students deal with subjects with the aid of computer programs according to their needs. With technology making it easier than ever to calculate a mathematical problem, educators determine the types of knowledge students need in order to advance in a workforce full of technology. Educational models of the past were focused on providing skills needed to translate students into skilled workers, but today's educators are more concerned with teaching students how to learn on their own. “The real purpose of education is to capacitate the brain for receiving information,” Greenberg said. “We teach students to learn to think, learn to learn and critically evaluate any situation.” Silicon schools CEO, Brian Greenberg, says that technology development does not undermine the role of a teacher. On the contrary, it increases it. “Technology is important, but it is not actually the main tool,” Greenberg said, “The real magic is done by a teacher.” With more data available to track the progress of each class, teachers are getting more and more insight into how students struggle. Math education software DreamBox provides educators with footage and information on how students learn and progress, so that teachers can focus on areas in which their classes need most help. DreamBox's learning expert, Tim Hudson, says: “In order for technology to function successfully in the classroom, it needs to be a means used by a teacher.” “It is important that we listen to teachers and administrators to find ways technology can aid them in the classroom,” said Hudson for Business Insider. When the Fourth Industrial Revolution starts, it is clear that technology will play a central role in almost all aspects of our lives. According to the survey by the World Economic Forum it is estimated that 65% of children entering elementary school today will end up working in completely new job types that do not exist yet.

### **3. A FUTURE BASED ON THE NEW STEM CONCEPT**

Why is STEM<sup>4</sup> so important? It is important because the future of the world depends on it. It deals with economy and general well-being - supported by science, technology, engineering and mathematics. Therefore, when it comes to STEM, it is not just coding and laboratory equipment. It is the basis of a complete production, food, health care, and so much more. If the importance of STEM is questionable, then there would be no problem for 2.4 million STEM jobs projected to remain vacant this year. There would be no serious underemployment of women in STEM areas.

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<sup>3</sup> Business Insider is a fast-growing business site with deep financial, media, tech, and other industry verticals. Launched in 2007, the site is now the largest business news site on the web. - [www.businessinsider.com/](http://www.businessinsider.com/)

<sup>4</sup> The term STEM is an English acronym for the four disciplines - Science, Technology, Engineering and Mathematics.

There would be no need for STEM in the centre of attention if these mass gaps do not exist. The lack of STEM education is the current problem at the global level. It is no secret that good education has the power to change life. What is new here is the demand for that change. As a company that thrives on innovation and technology, Cubic<sup>5</sup> is committed to promoting STEM education for children because it is critical to provide resources to foster the new generation of scientists, innovators and engineers. In an effort to raise awareness on the importance of science and technology, individuals and corporations increase their participation in coding competitions, scientific fairs and investment in classroom resources. The reason for that is simple as working in science, technology, engineering and mathematics (STEM) plays a very important role in the growth of the world economy. For example, according to the US Department of Commerce, STEM occupations are growing at 17 percent, while other occupations are growing at 9.8 percent. Therefore, it is important to promote STEM education for children under the age of 12, as STEM professionals will continue to manage the future of global innovations. Every year, Cubic takes part in a number of STEM-related events to raise awareness and get children excited about science and innovations. Recently, Cubic was involved in the EXPO Day, a part of the San Diego Science and Engineering Festival that promotes science in the local community. Cubic, along with a host of local businesses, corporations and nonprofit organizations exhibited at EXPO Day with interactive and practical activities at the exhibition of technological capabilities in the real world. Visitors attending EXPO Day had the opportunity to test Cubic's Multiple Integrated Laser Engaging System (MILES), robotic arms, facial recognition and Bandit Board at Cubic's stand. In addition to EXPO Day, Cubic is promoted as the sponsor of the Team America Rocketry Challenge (TARC) for the fourth year. TARC is the world's largest annual student rocket contest organized by the Aerospace Industries Association with a mission to build a stronger US workforce in STEM. Teams from secondary and high schools across the country compete for the opportunity to take part in the national finals held in France. This year is the 15th anniversary of the competition and 5,000 secondary and high school students have registered for the competition. Whether sponsoring, participating in events, or offering mentorship programs to students, Cubic is proud to invest in young generation who once exposed to STEM could become the next influential leaders on the list of technology and innovation of the present generation. Many governments invest more than ever in education of their citizens, wanting them to be competitive in the global workforce. The growing global middle class is spending more of its own resources on family education. Employers are looking for a new kind of vocation - someone who has the ability to affirm in the 21st century. Combined with technologies that continue to evolve at high speed, the result is the world that wants the learning tools on the ladder to success. We strive for education to better understand the process of growth and development of learning, motivation, successful adaptation, creativity and communication. Under the influence of cybernetics and system theorists, a renowned scientist and psychiatrist Berne began to separate the latent, hidden and psychological level from the manifest, conscious and social level of communication. He taught that people sometimes send messages from different levels, so that at the social level the message may sound factual and objective, while at the psychological level it may have quite different intentions (Nadrljanski, Đ., 2016, p. 11).

#### 4. CONSLUSION

Anyway, there is so much to be done. One in five adults lacks written communication skills they need to make progress in life, while 57 million children do not know how it feels to enter

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<sup>5</sup> Cubic Corporation gained importance with its participation in the 5th Annual National Science Leadership STEM, organized by the American Journalism and World Report. The conference was held in San Diego, California and brought together educational, industrial and political leaders to highlight solutions and programmes related to STEM that affect the entire nation.



the classroom. Millions of others are being educated but they do not learn effectively. The global challenge for education is not only providing access, but also ensuring progress. Leading global education businesses can help reduce the gap. Each individual country knows that the challenges are too huge to deal with them on their own. Therefore, a global community of teachers, parents, students, governments, institutions and companies should be encouraged to help find answers and implement solutions. In order to promote sustainable economic development to increase national prosperity, each country more or less tries to plan its economy development. The greater the importance or role of education in socioeconomic development, the more is emphasized the need for long-term and systematic planning of education development as a realistic policy. The significance and necessity of long-term planning of education, which is the key to promoting socioeconomic development of underdeveloped countries, is now recognized in developed European countries as well. Most of these countries usually carry out education reform within their national long-term educational plan. In addition, it should be noted that the new role of education is to encourage men and women with the initiative during drastic social development and changes that require planning of education. In education, it is not only important to acquire the knowledge and skills needed for a developing industrial society, but also to build a new type of character based on enriched and stricter morals. The role of science and technology in the future design of the economy and society in general will be discussed from the perspective of someone with a longstanding scientific experience. The reader would probably find his own characteristics of discussions that relate to many developed countries and developing countries. Since scientific progress is largely dependent on financial support and in modern times on general social support, it is convenient to discuss the interaction between science and society. The challenges facing higher education are as follows:

- Migrants fail more than non-migrants at BA<sup>6</sup> level. Higher education must help them succeed in their studies.
- Newly arrived refugees who attended BA or MA<sup>7</sup> degrees in their home countries were required to discontinue their studies. There is a need to solve these issues, for example by providing bridging programs, study guidance and mentorship, and promoting student inclusion and diversity of staff.

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## QUESTION OF ENTREPRENEURIAL DECISION: THE EVIDENCE FROM CROATIAN LAW

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### **ABSTRACT**

*Board liability is a topic that is intensively discussed in jurisprudence. The primary task of the managing director is not only to ensure a constant return on the capital invested but, albeit as a custodian of foreign assets, to run a business and to make the necessary entrepreneurial decisions. Entrepreneurial decisions always carry the risk of failure no matter how elaborately and meticulously are executed. Furthermore, in the majority of cases, there is not "the" right decision. An entrepreneurial discretion of the managing director exists as far as no instructions of the shareholders are present,. Therefore, directors are given a liability-free scope for entrepreneurial decisions based on the model of the "Business Judgment Rule" from the American Law. The Business Judgment Rule applies to business decisions only. An entrepreneurial decision is a decision of the management in matters of the management, which is not predetermined by the law, the statutes or instructions of the shareholders' meeting. Decision that is bound by the strict legal norm is not an entrepreneurial one. The entrepreneurial decision is characterized by the following: In the context of an entrepreneurial decision, the managing director, in the given situation, selects among various actually possible and legally permissible action alternatives. At the time of the decision, it is not yet clear whether the chosen alternative will be the most economically advantageous. The managing director is therefore required to make a prognosis. The subsequent assessment of the behaviour of the managing director also must be based on this ex-ante perspective. The decision of the managing director must be objectively comprehensible. In Croatia, the requirements of the liability of a member of the company for the obligations of the company are prescribed by the Croatian Companies Act in the provision of Art. 252. The Companies Act prescribes that the board members must conduct the business of the company with the care of an orderly and sound businessman and keep the business secret of the company. A member of the board of directors does not act in contravention of the obligation to conduct the business of a company if it can reasonably assume, when making an entrepreneurial decision, that it acts for the benefit of the company on the basis of appropriate information. This paper will shed some light on Croatian case law concerning the Institute of "Business Judgment Rule".*

**Keywords:** *Business Judgment Rule, Entrepreneurial decisions, Liabilities of the Parties, Corporations, Company's interests*

### **1. INTRODUCTION**

The Business Judgment Rule for directors is one of the most important provisions of the Corporate liability law (the "golden rule" or the "categorical imperative" for decision-makers). The content of the Business Judgment Rule is, in essence, that there is no director's liability with business judgment if the director could assume on the basis of appropriate information and comprehensive fact-finding that he had made its business decision in the interest of the company. This rule is a part of the most comprehensive liability norm in Croatian Corporate Law, namely the norm in Art. 252. Of the Croatian Companies Act (further: CCA). The mentioned norm governs the internal liability of the managing director (the liability towards the company) for the violation of corporate duties. Its purpose is, on one hand, to deal with the compensation of losses suffered unlawfully and, on the other hand, to set out the rules on prevention of damage by liability incentives (behavioral control).

The main controversy holds the question in whose interest the norm fulfils these functions: in the interests of the shareholders (interest monistic shareholder value model) or in the interest of third parties, especially employees, creditors and the public (Klöhn, p. 117). Besides various other duties, the dutiful behavior of Managers is founded on three pillars: The first pillar is the observance of legality obligations. The second pillar in the context of dutiful behavior is the observance of monitoring obligations. The third is the observance of fiduciary duties, so the director must act solely to the welfare of the company without own or anyone else's special interests (Goette & Goette, p. 815). The list of obligations arising from the norm Art. 252. CCA is long. Entrepreneurial decisions of the managing directors are associated with considerable uncertainties. Both macro factors (eg market and economic developments, exchange rates etc), as well as company-specific circumstances, can be foreseen only in an incomplete way. With business decisions the directors must analyze complex risks that are characterized by such factors but they find themselves exposed to the strict, virtually unlimited liability under Art. 252. CCA. In the light of this, three third-party liability instruments deserve particular attention. First of all, a legal tool of practical significance is the simple non-prosecution of the claim by the Supervisory Board. Also relevant for practice is the settlement, which has been used as a legal instrument in many cases and proved to be handy to free the directors from liability. Yet, it requires the approval of both the Supervisory Board and the General Meeting and can only be concluded after the expiry of a three-year vesting period (Art. 252 par. 5 CCA). These hurdles have been addressed in the Courts. The board members involved had to commit to substantial payments, although it was by no means clear that they had really violated their duties. This brings the Business Judgment Rule into focus as the last and most effective instrument of liability limitation (Bachmann, p. 105). Board members have a freedom of discretion in making business decisions. If the member of the Management Board can reasonably expect, based on sufficient information, that their decision is in the interest of the company, no duty contrary conduct exists. Thus, the provision which is in Art. 252. Croatian Companies Act provides "safe harbor" for business decisions of the Management. This regulation incorporates the Business Judgment Rule, which originated in Anglo-American law, into Croatian body of corporation law (Barbić, p. 795). Entrepreneurial action naturally carries with it the risk of failure. If an entrepreneurial decision leads to a financial disadvantage of a company, the question quickly arises as to whether the cause of this failure was actually the realization of the entrepreneurial risk or whether even a wrong decision of the directors was decisive for such outcome. As long as the decision maker complies with the requirements of the Business Judgment Rule, he should be granted freedom from liability risks. Of course, there is no liability for successful outcome of an entrepreneurial decision (Sieg & Zeidler, p. 56). The regulation known as Business Judgment Rule draws its justification from two general insights. First, It is difficult to judge a decision on its regularity, ex-post. Second, successful economic activity is not possible without taking reasonable risks. It follows that the Business Judgment Rule, on the one hand, represents a reduction of the judicial control standard and on the other hand a general management obligation to act in the interests of the company (Kocher, 216). The term "entrepreneurial decision" still needs to be clarified. Important characteristic of the entrepreneurial decision is a prognosis element, thus an action made with the element of uncertainty. Decisions not bound by the entrepreneurial decision are not included. The liability norm of Art. 252. CCA, in particular, does not apply to the fulfillment of fiduciary duty and to breaches of statutory, corporate or employment obligations. These measures don't give the managers any freedom of decision. Of particular importance in practice is the distinction between legal (statutory) obligations and entrepreneurial decisions. While there are no liability waivers in the area of legality obligations and their violation - the legality obligations are simply to be complied with - in the context of business decisions, liability may be granted in accordance with the Business Judgment Rule.

Just because the manager has made a potentially risky entrepreneurial decision, which later turns out to be a failure, there is no room for automatic, irrefutable assumption of a culpable breach of duty and thus the liability of the manager (Goette & Goette, p. 815). In accordance with the entrepreneurial decision-making situation, the Executive Board must in principle carry out an ex-ante assessment of the investment or an assessment of all available options for action based on their expected values. Entrepreneurial decisions are focused on the future and depend on a variety of external factors so that they are largely based on forecasts and, to a different extent, backed-up by the element of intuition and experience of managers. Against this background, an ex-ante identification of the "right" decision is usually virtually impossible. Above all, forecasting decisions, that is, those whose economic sense depends on future developments and their assessment, are of paramount importance. Courts would have to assess the behavior of board members from an ex-ante perspective but this is not always an easy task. Empirical studies show that even experienced judges are subject to an error because they are making decisions based on facts and events that have already taken place and the business decision had a negative outcome (so-called hindsight bias). Within the scope of corporate judgment, there is no judicial review of the appropriateness of the actions taken by the managers. Thus, the courts merely examine whether the managers have a discretionary power over the decision in question and whether they have exercised it properly. Decisive here is the ex-ante perspective. The judge shouldn't make his judgment according to what he knows and can recognize at the time the judgment is made, but should put himself in the position of the managing director and then ask what they could or should have known in the concrete decision situation and what they should or could recognize at that time (no hindsight bias). A breach of the Business Judgment Rule (e.g. due to insufficient information in the decision-making process) does not automatically lead to liability on the part of the managing directors, as long as their decision was dutiful (Schnoorbus, p. 1217). The managing directors must observe the methodical principles of proper corporate governance in the performance of their management duties. These principles limit the wide discretionary power of business executives in making business decisions. From them, it is required that management decisions are adequately prepared according to the circumstances and their importance. Director's decisions and their implementation should be made within the frame of established knowledge and best practices of entrepreneurial behavior, and that adequate control is exercised by the co-managers and employees of the company. This does not mean that the management methods that have been developed and tested in practice have normative character. In this respect, these are merely non-binding instructions. In individual cases, such rules, such as the principles of proper accounting or the principles of equity and liquidity of credit institutions, may have a normative character.

## **2. REQUIREMENTS FOR THE PRIVILEGE OF BUSINESS JUDGMENT RULE**

The irrefutable presumption of dutiful business conduct presupposes six facts. In detail, the following requirements must be fulfilled:

- it should be an entrepreneurial decision,
- manager should act a) to the welfare of the company, b) on the basis of appropriate information, c) without special interests and extraneous influences and d) in good faith.

### **2.1. Entrepreneurial decision**

The liability privilege that opens a margin for discretion is only applicable insofar as the measure in question is an entrepreneurial decision. This feature is primarily intended to distinguish those measures in which the behavior of the managing directors is already determined by law, by articles of association, rules of procedure or by effective instructions of the partners. In such cases, the managers must abide by the existing requirements and have no discretion that would allow them to deviate from such legal frame.

An entrepreneurial decision and a concomitant discretion are therefore only possible where the managing directors have several alternatives, all of which are legally permissible. If the legal situation is unclear in individual cases, the managers are not entitled to any entrepreneurial discretion, but only to a narrower scope of assessment. An entrepreneurial decision is the deliberate selection of a body of the company from several actually possible and legally permissible behavior alternatives, whereby at the time of the decision-making because of unforeseeable fact development it is not foreseeable, which of the available alternatives turn out to be economically most profitable for the company and therefore there is a risk that the choice made will subsequently be perceived by third parties to be clearly wrong from the outset. An essential feature of the entrepreneurial decision is, therefore, a forecast to be made by the managing director (Schneider, p. 2245). Incidentally, the deliberate omission of a particular measure may also be a type of behavior that is covered by the entrepreneurial discretion. In practice, this distinction is primarily a problem of proof: since the managers have to prove the entrance of the conditions for an entrepreneurial discretion, they should document in writing the reasons for their deliberate passivity (Schnoorbus, p. 1218).

## **2.2. Acting to the benefit (welfare) of the company**

Managers must also always be oriented to the welfare of the company. This requirement is difficult to grasp in practice. Standard against which this term is to be measured is itself a controversial one. In particular, it is unclear to what extent the interests of the shareholders, employees, executives and the general public can be taken into account and how the reconciliation of interests between them can be established. The concept of action is to be understood broadly; It includes the decision itself as well as the implementation of the decision, whether it is purely legal or factual action. This must also apply for an omission if and so far as a conscious (negative) is made choice among several courses of action. No entrepreneurial decision is, on the other hand, if the managers unconsciously and negligently miss a business opportunity or a limitation period. In any case, the long-term strengthening of the company's profitability and competitiveness will always be in the company's interest. How the directors bring this about is ultimately up to them, as long as they stick to the rules of proper business judgment. Ultimately, the circumstances of each individual business decision must be taken in consideration (Schnoorbus, p. 1218). Donations can also be considered to be the activity beneficial to the company. Whether there is a breach of an obligation to act as an orderly businessman, is determined by the question if the managers are empowered to use the assets of the company in such a way. Four criteria are used to distinguish authorized from unauthorized asset disposals: first, the lack of proximity to the corporate purpose, second, the inadequacy of earnings and assets, third, the lack of internal transparency and, fourthly, the existence of inappropriate motives, namely the fact that manager is pursuing purely his personal interests.

## **2.3. Acting on the basis of appropriate information**

The managing director must reasonably be expected to act on the basis of appropriate information. In this way, the legislature emphasizes the procedural prerequisites for the scope for action and liability in the phase of decision-making: it is necessary to carefully determine the basis of decision-making, which is particularly evident in the way in which information is obtained. There is no general obligation to obtain all conceivable information, nor is there any requirement for the best possible information, but it is a duty to thoroughly prepare the decision and make appropriate risk assessments in the specific situation. In general, the more important the decision for the company's existence and success is, the broader and stronger the information base must be. If the managing director, in the absence of his own expertise, seeks the advice of an independent, professionally qualified expert, after he has duly informed him of all the circumstances relevant to the assessment and has carried out his own plausibility check,

he can rely on this advice. (Fleischer 2009, p. 2339). Managers are not bound by the duty to fully exploit every conceivable source of information, so even the most costly and inaccessible ones. Rather, the required level of information is measured according to the specific circumstances of the case on the basis of a cost-benefit analysis. In particular should be considered the importance of the measure in question, the extent of opportunities and risks and the time frame of decision-making. Since such a balancing can never be carried out fully, the managers are also given discretionary powers with regard to the scope of information procurement. This also reduces the extent of the judicial review: The court can only check whether the managing director has obviously fallen below the required level of acquiring the necessary information (factual level of corporate discretion). The manager is allowed to pay a higher than the usual price for the product or service but this decision requires a justification so for instance if it is about a special quality, time savings or other benefits for the company are achieved. Otherwise, in many cases qualified counseling would not be needed at all. There is no need to mention that nothing different applies to the other types of expert counseling. The managers may not waste the company's assets. This means, in particular, that they shouldn't enter contracts that are detrimental to the company and company's may not be sold below value. In general, managers must always ensure that, from the perspective of the company, the best possible result is achieved. Conversely, the managers are not forced to always accept only the most favorable price offer. However, other aspects (quality of service, long-term predictability etc) may justify a higher price or lower profit. However, managers are not allowed to buy goods and services that doesn't serve to the welfare of the company. Also they are not allowed to make any payments on behalf of the company unless the company has a due duty to pay. If later it turns out that a deal was detrimental to the Company, then the directors must examine how further (additional) damage can be averted. Directors must assert a claim in the name of the company. However, if the assertion seems uneconomical or if it involves major disadvantages (disruption of the business relationship, loss of reputation, etc.), than the conscientious manager would probably not take this action further.

#### **2.4. Acting without special interests and extraneous influences**

In decision-making, manager action should be free from external influences and conflicts of interest and without direct self-interest. Managers must always follow the welfare of the company. Any conflicts of interest undermine the natural presumption that a managing director alone has the best in mind for his actions. If there is a legally relevant conflict of interest, it is generally considered to be harmful not only when the managers are acting for their own benefit, but also when acting for the benefit of related persons or companies. In life, managers are often subject to various duties. This is true typically with double mandates, in which case a director holds further offices in other companies. If a certain business measure involves both companies in which the dual mandate holder is appointed, the holder will be excluded from voting in view of the unavoidable conflict of interest. The Managing Director concerned should therefore refrain from initiating and executing the respective business on the part of both companies and leave the decision to his co-directors or obtain a directive from the shareholders. An exception applies only where business and company interests point in the same direction, such as the case with the decision for payment of profit-sharing bonuses (Fleischer p. 691).

#### **2.5. Acting in good faith**

Finally, it is one of the conditions for application of the "business judgment rule" that the manager is acting in good faith. If this is not the case and if even the manager does not believe in the correctness of his own decision, he deserves no protection. This corresponds to the international standards for directors and fits also perfectly in line with recent reflections to the grounds of validity and limitations of the director's freedom of judgment (Fleischer, p. 685). With the entrepreneurial decision, it is enough for the managers to be in good faith with regard

to the orientation towards the interests of the company, the absence of conflicts of interest and the appropriateness of the information basis. Managers are not limited to the purely passive management of company assets. Rather, the managing directors are obliged to actively look for opportunities and use them in the interest of the company. In principle, they are also allowed to consciously take risks. The decisive factor is that these risks are not inappropriate, ie that opportunities and risks are in a balanced relationship. Accordingly, the managing directors are not allowed to enter into any transactions that involve a high risk of damage, provided that there are no reasonable benefits that justify this risk-taking action. Apart from such extreme cases, there are many decision situations that are not readily attributable to a particular category. In practice, directors are advised to carefully prepare and document risky transactions in order to benefit from the principles of corporate judgment. Directors are not allowed to take huge risks which could jeopardize the very existence of the company. Such hazard decisions are exempted from the privilege of Business Judgment Rule. The Courts put it this way by saying: "...if the willingness to take entrepreneurial risks has been irresponsibly spanned..."(Lutter, p. 845).

### **3. SENTENCE IN THE CASE EXPO BIRO LTD**

The Croatian courts rarely dealt with the issue of business judgment rule, since it is a relatively new concept in Croatian corporate law. One of the rare known cases is the case of Expo biro Ltd held in front of Municipal Court in Varaždin (Nr. 7 P-1660/14-22). The plaintiff filed a lawsuit against the defendant, Expo biro Ltd Varaždin in which he sues the company for the total amount of 131,376.24 Croatian Kunas plus statutory interest. He states that Expo biro Ltd. never settled the claim in question. He further states that the defendant is the only member of the Expo biro Ltd and the only director - authorized to independently and individually represent the company. He states that the defendant as a director disposed of with the property of Expo biro Ltd in an unlawful way and with the intention to damage the creditors. Furthermore, as a director, he also misappropriates all movable property from the business premises in order to prevent the plaintiff from charging the claims. It considers from all of the above that the defendant in his capacity as a member of the board of directors acted with the intention to damage the creditor, especially considering the fact that in one case there was a claim for salary remuneration for years 2008 and 2009 and in the second case there was a claim for compensation for work injury for which the defendant had to be aware of as an employer and as the responsible person within the company. The defendant has knowingly violated the provisions of Art. 252 § 1 and 2 of the Companies Act and is liable alongside Expo biro Ltd Varaždin as a joint debtor to the creditors of the company pursuant to Art. 252, sec. 4. and 5. CCA. The defendant in his response alleges that he does not dispute the plaintiff's claim to the company Expo biro Ltd but denies that he is liable for the debts of Expo biro Ltd because at that critical time he was not the responsible person in the company. He further alleges that he does not deny that he represents the company individually, but only from 15 January 2010, thereby disputing the allegations of the plaintiff that he has sold the assets of the company only to damage the creditors. Based on the procedure so conducted, considering each and every evidence separately and all of them together, the Court rejected the plaintiff's claim. It is indisputable that the plaintiff has a claim against Expo biro Ltd Varaždin in the total amount of 131,376.24 Croatian Kunas, as it is also undisputed that the company's claim in question was not satisfied. Furthermore, it is indisputable that Expo biro Ltd Varaždin was deleted from the court registry and that before the deletion the director of the company was the defendant. The question is whether the defendant here, as the responsible person of the company Expo biro Ltd Varaždin, failed to conduct the affairs of the company with the care of an orderly and conscientious businessman because he sold the property of the company and thereby damaged the creditors. The assumptions of the liability of a member of the company for the obligations of the company are prescribed by the provision of Art. 252 Companies Act. The mentioned norm provides that directors must conduct business with the attention of an orderly and



conscientious businessman and keep the business secrets of the company. The director does not act in contravention of the obligation to conduct the business of a company if it can reasonably be assumed that director, when making an entrepreneurial decision, acts for the benefit of the company and on the basis of appropriate information. Managers who violate their obligations are liable for damage to the company as solid debtors. In the case of a dispute before the Court of Law, board members must prove that they have applied the attention orderly and conscientious businessman. Claims for damages can also be filed by the company's creditors if they can't settle their claims from the company. This rule applies in cases only if the director has grossly violated the duty to apply the attention of an orderly and conscientious businessman. In relation to the company's creditors, the obligation to compensate for the damage can't be eliminated by concluding a settlement on the request, nor by the action based on the decision of the general assembly. Therefore, in order for the creditor to settle his claims towards the director of the company, two assumptions must be fulfilled: 1. inability to be reimbursed by the company and 2. gross violation of the Director's duty of care. The burden of proof of the existence of facts indicating such a qualifying liability of a member of the board is on the plaintiff. The directors of the company must conduct the business with the care of an orderly and conscientious businessman, that is, with the attentiveness of a good expert when making business decisions. Entrepreneurial decisions include all decisions relating to the management of the company and the representation of the company towards third parties, which directly or indirectly concern the well-being of the company and the benefit. This is observed from the viewpoint of the member of the management in the situation and circumstances as they were at the time when the decision was made. The director is obliged to act with the attention of a good expert, which means that when making an entrepreneurial decision it can reasonably be assumed that the action is based on appropriate information and that the director acts to the welfare of the company. When assessing whether the director has complied with this legal provision, it is necessary to take into account the criterion for determining a reasonable assumption of the effect that a certain business measure has on the welfare of the company. This reasonable assumption should be a benchmark determined by a person who possesses a certain amount of knowledge and experience that exceeds the amount of knowledge and experience the average person possesses. The object of the legal analysis will be the quantity and appropriateness of the information obtained by the director, in order to make the decision based on it. If the information was appropriate, the director, referring to the rule of business judgment, could be released from liability for any damage caused by his decision. Obviously, the defendant has not voluntarily disposed of the property in question by selling it or disposing of it in any other way but the property was sold in a judicial enforcement proceeding so in the process of forcible settlement of the creditor. Defendant did not sell or voluntarily dispose of the property in question, nor did it have any influence on the previously entered pledge rights, for which settlement procedure was initiated, whereby that fact of the sale of the real estate itself may not be regarded as a gross violation of the attention of an orderly and conscientious businessman. Plaintiff had a burden of proof of such conduct by the defendants. Plaintiff failed to prove that the defendant would in any way cause the financial problems of the company. Furthermore, plaintiff stated in his testimony that Expo biro Ltd owned some vehicles, two vans, a forklift, and some tents. It seems that plaintiff did not attempt to enforce execution on the motor vehicles of the company, which would lead to the conclusion that the defendant had unlawfully disposed of them. The plaintiff did not even submit any other evidence that it would be apparent that the company had those vehicles. Given that the plaintiff did not substantiate any of the claims in question, the Court, by applying the burden of proof of law, concludes that the defendant did not sell any movable property of the company. From this court decision, we can learn that Croatian courts recognize a business judgment rule. This is a good sign and an indication that courts protect the right of the director to make a business decision. The director

must have the freedom to make decisions. Business decisions must meet the criteria of a business judgment rule. This means that it must be an entrepreneurial decision based on the appropriate information, made to the welfare of the company and in good faith.

#### 4. CONCLUSION

In general, the directors within their duties on proper management have to contribute actively to the welfare of the company and to avoid all potentially harmful situations. This is the range within which the specific duty program of proper business management moves. Business standards can sometimes be used for orientation but the managers are liable only if they break the Law. In detail, however, the standards of business conduct against which the behavior of the managing directors can be measured can only be substantiated by practical examples. By every enterprise, a decision is to be checked, to begin with, whether with the decision the welfare of the company is protected. Only if one can conclude that the decision serves the welfare of the company, managers are protected from personal liability. The business decision must be met without foreign leverage and conflicts of interests. In particular, the pursuit of director's own, private interests contradicts the company's welfare. The decision must be made on the basis of adequate information and in good faith. The Business Judgment Rule reduces the density of judicial review and allows managers to make mistakes and to take reasonable risks. At the same time, the rule specifies general obligation of the executive board to act in the interests of the company. It has several advantages over the other liability-limitation instruments, because it takes effect immediately and without prior agreement, functions independently (without the need of approval from other organs of the company), reduces liability to zero, and excludes other sanctions for breach of duty. It is not a rule on liability for a successful business measure but for the measure which was taken by following certain standards. Rather, it is crucial that the decision from ex ante point of view was justifiable, even if a potential risk was realized later. It is to be ensured by this that the directors are not exposed to the strict liability right from the start. Risk-taking is a positive thing and managers should not be discouraged from it, just fairly warned about the boundaries of such a behavior.

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## TOWARD NEW STRATEGY OF INTEGRATION OF WESTERN BALKANS

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### ABSTRACT

*The strategy for integration of the Western Balkans arose from the analytical perception that the "price of non-affiliation" of the region towards the EU is very high in situations when it brings the potential to consolidate the disintegration scenario at a wider regional scale. The economic impoverishment of the region is presented through the striking fact that the gross domestic product is 8.5% of the European average! The analysis of the macroeconomic profile of the region confirms the thesis that contemporary tendencies are increasingly being explored within the development model of center- periphery. The degree of peripheralization of the region is a logical derivation of the unified matrix for entering the global market within International and European policies. In the modern geopolitical perspective the divergent tendencies in the region in relation to European processes have again revitalized the interest of European policies that resulted in a "new" strategy for economic integration. The strategy supports the processes of progressive EU integration through the inclusion of this region in the "convergence machine". The dilemmas and controversies regarding the innovative elements of the strategy for economic integration are seen from the point of view of new theories of economic growth and the possibilities for them to be realized in the direction of policies that will support the integrative and cooperative processes in the region. Thus, the strategy becomes the ground of re-examination of the mix of the national and EU policies in Western Balkan countries as highly fragmented economic spaces that will require multiple efforts and resources in the future. As a result, the shift of policy focus from stabilization to development must have a clear spatial dimension and should be characterized by the formulation and implementation of active policies toward Western Balkans. Finally it can support political cooperation and contribution to political stabilization in the region.*

**Keywords:** *Western Balkan, Economic integration, center- periphery, economic growth, convergence machine*

### 1. THE CONTRADICTIONS OF THE CENTER- PERIPHERY MODEL OF EU

The European economy has changed in many important ways during the last decades, either due to market forces and dynamics or institutional change and policymaking. In addition, Europe itself has changed, as the old divides – both actual and perceptual – are in the process of being altered and replaced by new ones. The driving forces of change are two fundamental, parallel and interacting processes: the first is related to the operation of the Single European Market (SEM) and the other is related to the economic transformation and the westward orientation of the Central and Eastern European (CEE) countries. The policies of EU integration are mostly market-oriented policies aiming to increase the efficiency and competitiveness of the fragmented European economy in the face of increasing globalization of economic interaction. The evidence provided indicates that the process of integration in Europe is associated with increasing spatial disparities at all levels, suggesting that, under existing policy

trends our common European future will be a multiply divided one. To a large degree, these disparities do not seem to have a transitory character, as they are affected by objectively conditioned processes. EU integration leaves winners and losers (Winters et al, 2004, pp. 72-115) by exposing regions with unequal endowments in resources and technology and different economic structures to international competition. In general, peripheral regions with weak economic structures and deficient infrastructure and human resources have fared worse in the integration process. One of the reasons is that, sectoral specialization and North-South or core-periphery trade in the EU still maintains an inter-industry character. The core regions specialize and export to the periphery high-tech manufacturing and producer services, while the periphery exports to the core regions low-tech manufacturing or extracting activity products. As a result, trickle-down effects assumed to stem from the core regions to the peripheral ones will be limited (M. Jackson G. Petracos 1999). On the other hand, the SEM has resulted in an increase in the market penetration of regions lagging behind increasing trade deficits and increasing the erosion of their productive base. Funding of the deficits occurred by the countries of the Center, which capped the surpluses of financial resources from the expansion of the real sector (high-tech technology) but also on the expansion of the financial markets. Liberalization and market deregulation allowed the Center's free money to mobilize in the face of increased demand on the periphery. Thus, the "relations of the forces" were consolidated in the market, which very elegantly manifested the new division of the European space of the developed Center and Periphery (Nikolovska & Mamucevska, 2015, pp. 45-62). On the periphery the region of the Western Balkans is established, extremely marginalized by European development trends with African dimensions of poverty. Today's situation in the region is clearly presented by the fact that the gross national product per capita is only 8.5% of the European average! (Action Plan, Regional Cooperation Council, 2017). On such an economic base, the "new era" in the Balkans is formed, which contains all the assumptions for opening completely different perspectives. Globalization - regionalization - tribalism is becoming part of the complex geopolitical structure of an unprecedented region. If we express ourselves with a mathematical metaphor - the Balkans currently has three vectors, each of which drags on its side. The equation with three vectors does not have a single solution. Finally, resolving such a complex state requires awareness of the fact that both vectors are active today, globalization and its by-product in the Balkans - tribalism. The liberal attitude towards these trends of the international community has the significance of accepting regional conflicts, clashes, wars as a natural course of events.

## **2. GLOBALIZATION OF THE WESTERN BALKANS**

The inclusion of countries of Western Balkan in the global market happened through the IMF stabilization and structural adjustment programs. The dogmatization basis of this programs is conceived as a combination of neo-classical liberalism and orthodox monetarism, which is nonsense in economic terms, i.e. this kind of doctrinarian influence is, from the very onset, destined to bring us into a “blind alley”. Over the years of realization of the program all the starting principles underwent a metamorphosis into their opposites (see Table 1). The result obtained is a vulgarization of the entire project and bringing it down to monetary alchemy in which stabilization of prices and currency lost any connection with the destruction in the real (primary) sector.

*Table following on the next page*

*Table 1: Demystification of the IMF stabilization and structural adjustment programme  
 (authors own view)*

Initial hypothesis	Consequences
Restrictive fiscal policy	Blossoming of mega- budget state
Restrictive monetary and lending policy	Internal debt accumulation
Stable exchange rate policy	External debt accumulation
Liberalization of economy	Capitulation of economy
Structural adjustment	Dismantling of the economic structure (de-industrialization), segregation, disorganization. Blossoming of the informal sector

After the initial stabilization shock, the region continued in the framework of the realization of the European integration perspectives. Such a process confronts the region with political, legal, economic, social adjustment policies (Copenhagen criteria). The course of the processes was determined by the possibilities for revitalization of the economic reforms in the region. In turn, they have been given the direction of passive adaptation to the old stabilization schemes now altered in the guise of the Maastricht convergence criteria. The precisely formed macroeconomic profile of the region reflects the conflict of nominal criteria with the real convergence. In fact, the region is "stabilizing" and structurally adapting to the "strategic navigation" of the EU, which actually had a dubious significance. Thus, the macroeconomic indicators of the western Balkans "radiate" with nominal convergence (low inflation rates, stable exchange rates, average deficits and moderate public debt) (see *Table 2*).

*Table 2: Key Economic Indicators of Western Balkans (World Bank, 2017, pp. 61-63)*

WB6	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (percent)	2,5	0,3	2,2	2,9	2,6	3,3	3,6
Consumer price inflation (percent, period average)	0,8	0,2	0,5	0,9	1,8	2,1	2,0
Public expenditures (percent of GDP)	37,8	38,8	38,0	36,7	37,5	36,6	35,8
Public revenues (percent of GDP)	33,7	34,7	34,7	35,2	35,5	35,1	34,9
Fiscal balance (percent of GDP)	-4,0	-4,1	-3,3	-1,4	-2,0	-1,5	-0,9
Public debt (percent of GDP)	42,4	46,8	49,2	48,6	48,4	48,4	46,9
Public and Publicly guaranteed debt (percent of GDP)	47,4	51,5	54,0	53,3	53,2	52,9	51,7
Goods exports (percent of GDP)	24,0	24,7	25,2	26,7	28,0	29,2	30,3
Trade balance (percent of GDP)	-16,3	-16,7	-15,1	-13,3	-13,3	-12,7	-12,1
Current account balance (percent of GDP)	-6,3	-7,0	-6,1	-5,5	-6,1	-5,9	-6,0
External debt (percent of GDP)	77,2	81,9	82,4	82,7	83,6	83,5	82,6
Unemployment rate (period average, percent)	24,2	24,3	23,2	20,8	n.a.	n.a.	n.a.

At the same time, there is a real divergence that is manifested through the low gross domestic product per capita and the high unemployment rate (average 23%). The unfavorable trends in the export-import flows are a consequence of the destruction of the production base of the region and as such are the reason for the stable high trade deficits (15%). They are mostly covered by private transfers (labor exports) and a smaller proportion through inflows of foreign direct investment and international borrowing. International borrowing has a stable growth trend, the external debt of the region is high and accounts for over 80% of GDP. The stabilization efforts of the region as a neuralgic point indicates the fiscal sphere.

Even though the public debt is within the Maastricht criteria and deficit spending is not dramatically high. However, the located problems in this segment are considered to be crises due to the fact that the "mega-state" which during the cleaning of economy (des-industrialization, des- agrarization) gave birth to a historical paradox, the mafiotic state. Such state distorts the poorly developed market structure of the region through corrupt resource allocation schemes. In addition, the state is still borrowing heavily on the domestic and external capital markets (public debt app. 48%).

Thus the western Balkan is a region that is quite homogeneous in relation to the typical parameters for the periphery of capitalism such as: Extreme unemployment, large debt, concentrated (oligopolistic) structured market, the grey economy, corrupt and criminalized society.

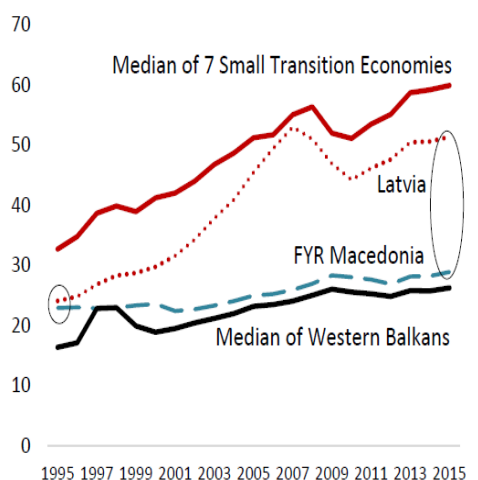
### 3. WESTERN BALKANS IN EU INTEGRATION PERSPECTIVES

The contradictory perspectives of the EU stem from the way in which it balances the processes of functional integration of large capital (efficiency, competitiveness) and the interests of peoples' communities (uniformity, cohesion). The contradiction of these interests is relativized within scenarios (Boonstra, 2017) that suggest different strategies, policies to address the current crisis. The scenarios can be systematized into two groups:

- Positive outcome (further integration)
- Negative outcome (European disintegration).

Within both scenarios, the security risks are highly prioritized, especially due to the new geopolitical shifts. In the constellation of such conditions, the problems of the Western Balkans leaked to the surface. The region began to be perceived in two ways: As a stabilizing anchor that could contribute to the EU's evolving dynamics and strengthen integration processes, but also as a "Pandora's Box" that could jeopardize integration processes. The EU made the choice: A political consensus was formulated for high-level establishment of the problems of the Western Balkans in European policies. The consensus emerged from the analytical perception that the “cost of not being part of” the EU region is very high. Such cost is illustrated by the example of Latvia and Macedonia. These two countries at the start were at the same level of development (about 30% of the EU's average gross domestic product in 1995) Today, Latvia reaches 60% of the European average while Macedonia moves within 35% (see *Figure 1*).

*Figure 1: Starting from a similar level of per capita income as Macedonia, Latvia was able to grow much faster (GDP per capita as share of EU's international 2011 PPP US\$, percent)  
(World Bank, 2017, p.2)*



Divergent trends in the region occur through low economic growth rates (2-3%), in which convergence with the European average should materialize in an indecent long period of 90 years (RIMED, 2004). That is why economic policies towards the region should be articulated to meet the magnitude of the existing problem (divergence). In fact, a logistical and financial framework needs to address the structural weaknesses in the region. The radical reversal of the processes and the realization of higher growth rates (6-7%) on which the development tendencies towards EU convergence can be focused, may change of the economic policies of the region. The new strategy builds on the footsteps of dynamic macroeconomic policies. The World Bank indicates three driving for the region: macroeconomic stability, progress in transformation of economies and integration (World Bank Group, 2017, p. 2). The new component in the Strategy is the great importance given to regional integration as an opportunity to mobilize the internal traction forces based on the development of the intra-Balkan co-operation in different segments of the economy. Lopez-Calva and Lustig (2010) suggest that economic integration has the added potential to reduce income inequality if it is sent with appropriate social policies. In this case economic prosperity in social cohesion is the right path for the stability of the region. Building additional input through the integration policies in the region requires changes in the function of the state. It should conquer the new function of a smart government that will dislocate discussion of intractable national issues and problems in a European context where they become solvable. Such an option leads to an all-win situation as it opens space for affirmation, promotion and realization of the key factors of the integration process. Thus, the region corresponds with the historical necessity of forming a prosperous economic space from the Atlantic to the Black Sea, from the northern sea to the Mediterranean. The United States of Europe in such a vision is becoming a project that is not much more difficult and different from the establishment of the USA two centuries earlier. For the Western Balkan countries, this is the best scenario for returning to the prosperous future of its "glorious past".

#### **4. ECONOMIC INTEGRATION WESTERN BALKANS**

##### **4.1. Theoretical Background**

Economic integration The Western Balkans has its own theoretical fundus within the framework of the new theories of economic growth. Modern theories of economic development skip the "weak points" of neoclassical doctrine (lack of capital, labor) and give a broader perspective on development opportunities within technological changes, changes in communication and digital information systems. Fundaments in building development perspectives are located in the "endogenous capacity" to produce knowledge and it is effectively used to foster innovation. (Stimson, Stough, Roberts, 2006, p.335). Such context is very close to the concept of "regional systems of innovation" (Doloreux, 2003, pp. 67-94) as a suitable basis for the creation, use and dissemination of knowledge. Thus, regional integrated systems are becoming a real ground for opening up favorable development perspectives of the region. Such conveniences are realized not only because of the economies of scale (the big market), but also because of the "economy of synergy" that mobilizes the potentials of networks within the specifics of local markets. In accordance with the new economic theory, accelerating the growth of the region can occur by induction of growth from one state of equilibrium to another state of more equilibrium. Such an incentive can occur through the modern determinants of economic growth such as:

- Dense innovative network of business firms
- Investments in R & D
- Development of human capital
- Development of an effective information structure
- Agile State and its role in creating a business climate

- Creating economic policies which in the underdeveloped regions should be oriented towards modifying the prices of factors in the direction of encouraging the economy to offer propulsive "innovative" activities.

The new economic theory actually ends with the monetary orthodoxy that nominal convergence is a fundamental factor for building comparative and competitive advantages. As Pitelis and Taylor conclude, these criteria did not contribute to improving competitive positions in any country. (Pitelis & Taylor, 2000, pp. 46-61). Thus, the only reasonable concept for enhancing competitiveness is through cluster grouping that absorbs all dynamic phenomena of contemporary development as a factor for raising national and regional productivity and thereby the well-being of the population. (Porter, 2000, p.253). Such a process has its own mediator "smart government". It should create public policies capable of creating regional learning infrastructures. (Stimson, Stough, Roberts, 2006).

#### **4.2. Economic Integration Policies**

The foundations of the regional economic integration Western Balkans are set up as a result of the "Berlin Process" that was crowned in Trieste (2017) by adopting a multi-annual Action Plan for the Regional Economic Area of the Western Balkans (PAP). The plan is signed by the leaders of the six Balkan countries (Bosnia and Herzegovina, Macedonia, Serbia, Montenegro, Kosovo and Albania) who committed themselves to its implementation in the period up to 2023. The action plan stems from the commitments under the Free Trade Agreements zone (CEFTA) and the strategy for Southeast Europe 2020. It is based on the rules and principles of CEFTA and the EU and it addresses a range of activities aimed at regional correction in the field of trade, investments, the digital economy, mobility of people in order to overcome structural weaknesses and the release of dynamic halves in the region. Within the financial support of regional integration in the Western Balkans, 1.07 billion for 2018 is provided. This is a significant increase in the total EU investment in the region over the last decades (8.9 billion Euros). Additional financial opportunities are open through EBOR, ECB and IPA funds. In addition, the region gets the opportunity to participate visibly in the creation of the Multi-Annual Financial Framework of the future cohesion policy. The implementation of the project requires the mobilization of forces on the broad front through the development of partnerships (Multilevel governance); coordination between national partners, but also cooperation with European institutions, business partners, sponsors in a very wide process of transfer of knowledge, experiences and practices.

##### *4.2.1. Trade policy*

In modern terms, "mainstream" economists consider trade in particular export as the leading factor in economic development. That is why the focus of the Strategy is on the development of regional trade relations. Moreover, the total export of the Balkan countries is at a low level of 40% of the GDP, which is a significant lag in terms of exports of the small countries in the EU (about 80%). Especially to mark the fact that the exchange between countries within the region is only 10% of their total exchange!

The action plan for the Western Balkans economic region, the unused potentials to strengthen the integration of the domain of trade relations in the region is required in:

- Reduction of trade (customs) costs and non-tariff barriers, as well as full regulation of the issue of the accumulation of origin of goods.
- increasing the market for services that were not covered by the CEFTA and which, with additional Protocol 6, receives a legal framework for liberalization.
- Activation of potentials in the domain of propulsive ICT service that can shape the future profile of the region in the direction of products with increased added value.



In order to realize a larger spillover effect than trade integration, it can take the form of developing a Free Trade Area or a Tariff Union. With the regional trade integration of the Western Balkans, an important step will be made in the conditions when it is more efficient and more pertinent than the bilateral trade relations, because they reduce the administrative costs (which are a weak point in the current system) and create more transparent and more correct trading regimes. In this way, not only will the static and dynamic values of integration be promoted, but an important step towards political dialogue and political cooperation in the region will be made.

#### *4.2.2. Investment policy*

The Western Balkans region on the European Investment Map is presented with very modest amounts. That is why opening a new investment cycle and starting structural reforms is a crucial issue that is tied to the region's development perspectives. From here, the effort within the Strategy, especially in the Action Plan, is directed towards the adoption and implementation of the so-called: Regional Reform Agenda for Investments. The agenda should increase the region's attractiveness for investments and increase capital inflows, primarily through the creation of unified and harmonised standards and norms with the respective once of OECD, UNCTAD and EU. This will improve the business climate in the region and prevent the spread of the informal economy which, besides the lack of capital, is identified as a second significant barrier to doing business (World Bank Group, 2017, p. 12).

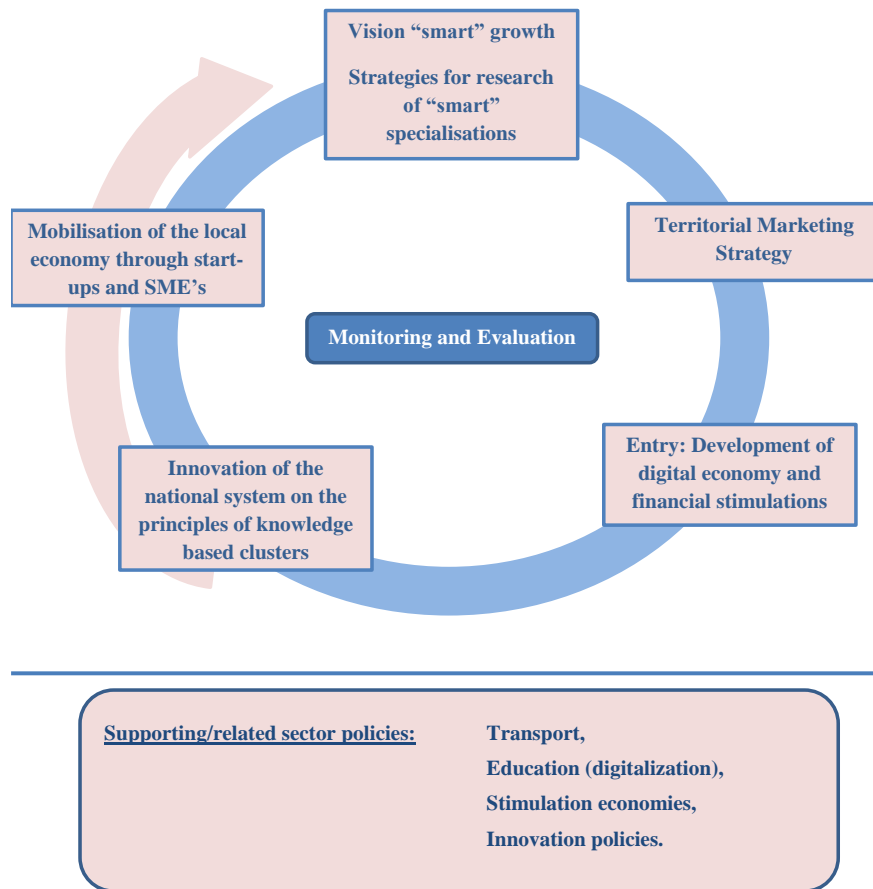
The investment agenda focuses on the following important issues:

- Determining a database for the conditions of the scope of the investments in the region (regional investment information database),
- Establishing a regional framework that de jure and de facto will ensure convergence to EU standards and best practices in the field of investments,
- Creating a vision and strategy that will argue, operationalize and realize the directions of the region's movement towards specialized smart platforms that will enable the prospects of the region,
- The reform agenda should incorporate the regional approach into attraction and promotion of the investment cycle in the Balkans in terms of economy of scale, economy of synergy, and within the inexorable potentials, especially in the service sector,
- The Investment Agenda should include the Development Component of FDI, i.e. to support the process in the direction of the development of local economies. (Dicken, 2007)

The ultimate goal of the investment agenda is the Western Balkans to be affirmed as a destination with its own profile. Thus, in the framework of the investment Agenda, the opportunities anticipate the region to be profiled in the direction of smart growth. Implementation of a small group of focused activities in the sectors of the so-called smart growth should be incorporated into core areas investment policy (The World Bank, 2017, p. 20). Model of the investment cycle for smart growth is presented below: (see *Figure 2*)

*Figure following on the next page*

*Figure 2: Authors own investment cycle model based on the Core area of Investment policy presented by the World Bank (World Bank, 2017, p.20)*



## 5. CONCLUSION

Globalization requires economic integration. In the neighborhood, the EU example is the most illustrative evidence of a prosperous and sustainable development model. Balkan states within the European space remained fragmented, backward provinces from which people are fleeing and they are "choking" in anachronistic political processes. That is why the European initiative for greater economic integration of the region is an opportunity to get out of the deadlock of "terra incognita" (balkanization). In fact, geopolitical processes and displacements have driven the eyes of the region. Thus within the functional integration of European space it was understood that: 1. Western Balkan belongs to the EU; 2. It is necessary to implement proactive policies towards the region. EU proactive policies towards the western Balkans are conceptualized within the framework of the findings of new economic theories of growth. They aspire to give an external input to the region in order to transit to a new state of "more equitable balance". The vision of an organized region with a large expansive and sophisticated Balkan market is complementary with the processes of consolidating European competitiveness on the one hand, as well as strengthening the integration processes in the European space, on the other. However, the realization of integration requires strong autonomous support for national leadership and citizenship in the Western Balkans. This is again "captured" in the visions generated by the political retrograde fundamentalism, that in combination with the global shifts is pushing the Balkans towards new tribal fights for fragmentation. Exactly in such constellation the following questions remain open: Will the enlightened internal forces recognize the unique chance that opens in front of the Western Balkans?, Is economic integration an incentive to

economic convergence or a new misconception?, Will the Western Balkans finally be Europeanized or sink into scenarios of Africanization?. One is clear that the issue of the destiny of the region is not rhetoric, but is a crucial issue. Whatever happens in the western Balkans will have a contagion effect on the EU.

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## COURT AND OUT-OF-COURT SETTLEMENT IN CRIMINAL PROCEEDINGS AS THE SIMPLEST WAY TO COMPLETE THE PROCEDURE

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### ABSTRACT

*In Croatian criminal justice legislation, the fully implemented and standardized settlement, apropos a judgment under the Agreement of the Parties, as an alternative and agreed way of completing the criminal procedure, was done by the amendments of the Criminal Procedure Code in 2008. By such alternative regulation of process capabilities, Croatia joined the legal systems that had fully implemented conciliatory way of completing the criminal procedure as de iure as well as de facto. In this paper the author will try to analyze and point out the occurrence of so-called concealed agreement, since our legislator limits the possibility of achieving a strictly formal settlement under the Plea guilty and sanctions Agreement cogently to the phase of accusations exposure. However, in judicial practice the possibility of concealed negotiation and informal settlements has proved to be effective and has taken up a significant percentage of the total number of criminal proceedings. Analyzing the final judgments of the Municipal and County Courts in Split, it is logical to conclude that all those judgments that became valid after the first-instance decision, that is, without the appellant's or prosecution's appeal, are essentially the result of the concealed agreement or settlement. At European and global levels, the achievement of a formal or informal, out of court settlement has proven to be the most effective model of finishing criminal proceedings. In spite of its noticable restrictions, such as the lack of "specific" mitigation of punishment, reserved for formal Plea guilty and sanctions Agreement, concealed agreement has become implemented through practice in a strictly formal court proceeding, overcoming this legal gap. This paper attempts to point out a legal disadvantage caused by a strictly formal limitation of possibility for achieving Plea guilty and sanctions Agreement at a certain stage of the proceedings, since the courts praxis has shown that, at some point, during the lengthy court proceedings, partially derived evidence and financial burden of defense costs, defendant would like to conclude a procedure by formal settlement. A settlement that applies the principle of "specific" mitigation of punishment, which would be appropriate at all stages of criminal proceedings, with the appliance of the principle of guilt individualization and compliance with the basic principle of legality. Such a model would represent a step towards modern tendencies of mixing, at a glance, the essentially different principles of legality and opportunism.*

**Keywords:** court settlement, out of court settlement, criminal proceeding, concealed settlement, plea guilty, plea guilty agreement, sanctions agreement

### 1. INTRODUCTION

Most of disagreement between comparative criminal law experts lies in incomprehension of unilateral official concessions given to the defendant in exchange for co-operation with the authorities. The widespread practice of expressly concluding agreement on the exchange of benefits and mutual compromises between prosecution and the defense, until recently, was far from close-knit to continental legal understanding. Approaching to procedural problems from different positions, where many procedural means are differently evaluated, by observing the same subject, different realities may arise as a result of different perceptions. Anglo-American legal reality has its specific legislative solutions in criminal proceedings, with a basic starting point in determinatoin of party truth without the imperatives of seeking material truth as the

fundamental determinant of righteousness. Its antipode, based on legal understanding of continental law, finds the righteousness being satisfied only by establishing the material truth. Such seemingly controversial doctrines have a completely identical goal, that is the efficiency of a state apparatus in the punishing process of perpetrators of the crime and the effectiveness regarded to general prevention that provides legal and physical security to all subjects that are protected by of criminal law norms. Traditional continental systems held almost unacceptable to give the prosecution and defend the controle of choosing the criminal sanctions. Putting the accused into negotiating position was found to be a direct threat to states sovereign prerogative to determine criminal policy.<sup>1</sup> Although it is true that in some continental systems it is expected of states attorney to suggest a specific sentence, such recommendation for the judge is non-binding and does not interfere with it's sovereignty in determination of punishment. In America, prescribed punishments are mostly a means of parties manipulations with the aim of achieving the best outcome. In the settlement sphere, the question is whether the private interest of the accused to improve his position is inherent or an opposite to the state interest to pursuit of punishment policy? We are witnessing that the implementation of effective and rapid criminal proceeding resolution modalities has virtually surpassed the strict divisions of the Anglo-Saxon and Continental legal systems.

## **2. COURT SETTLEMENT SPECIFICITY AS A STRICTLY FORMAL PROCEDURE IN THE LEGAL SYSTEM OF THE USA**

The differentia specifica of Anglo-Saxon approach, regards to Continental legal doctrine, lies in its traditional fundamentals differences. The specificities of Anglo-Saxon approach, reflected in the way of court settlement arrangements in criminal proceedings, have only recently entered into criminal law systems of Continental countries. The „pioneer“ of such specific way of solving criminal cases, with a high share in the total number of criminal cases, is the legal arrangement of the bargaining institute in the United States. Despite the defendant's consciously waiver of his constitutional rights and the rarely but persistent moment of state's attorneys force to accept the agreement, it became an institute deeply rooted in the practice of domestic courts in the United States as a foundation for criminal justice process.<sup>2</sup> Prosecutors have powerful instruments that encourage the defendant to agree with the settlement, which, in the context of the draconian upper limits of the imposed sentences, makes the ability of the prosecutor to dismiss the individual parts of indictment very attractive for the accused to advertise guilty.<sup>3</sup> The parties' agreement procedure is closely regulated by the Federal Rules of Criminal Procedure (hereinafter referred to as the FRCP) within the framework of the Fourth Chapters entitled „Arrest and Preparations for Trial“. Rule 11 (Pleas) regulates the procedure and circumstances of Entering a Plea (a), Considering and Accepting a Guilty or Nolo Contendere Plea (b), Plea Agreement Procedure (c), Withdrawing a Guilty or Nolo Contendere Plea (d), Finality of a Guilty or Nolo Contendere Plea (e), Admissibility or Inadmissibility of a Plea, Plea Discussions, and Related Statements (f), Recording the Proceedings (g) and Harmless Error (h).<sup>4</sup> Two types of agreement are govern; "charge bargaining" (an indictment agreement) and "sentence bargaining" (sanction agreement) under the common denominator of the "plea agreement procedure". The "sentence bargaininig" concept implies an agreement on punishment which seems to be simply and ultimately solution, while in essence, under the clear

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<sup>1</sup> Damaška, M.; Lica pravosuđa i državna vlast; Usporedni prikaz pravosudnih sustava, Nakladni zavod Globus, Zagreb 2008., p. 125.

<sup>2</sup> An extremely high percentage of agreeably solving criminal cases (90 to 95%) is incognito the result of a forced application, especially in the absence of evidence on the prosecution side. Cf. Devers, L., Research Summary: Plea and Charge Bargaining, Janaury 24, 2011, Bureau of Justice Assistance, U.S. Department of Justice, p. 3 and 4.

<sup>3</sup> Cf. Damaška, M.: Napomene o sporazumima u kaznenom postupku Hrvatski ljetopis za kazneno pravo i praksu (Zagreb), vol. 11, No. 1/2004, p. 12.-13.

<sup>4</sup> [https://www.law.cornell.edu/rules/frcmp/rule\\_11](https://www.law.cornell.edu/rules/frcmp/rule_11)

rules of the FRCP (11 (c), 3, C FRCP) such agreement does not oblige neither the parties nor the court who ultimately confirms the settlement with its verdict. Because of the absence of a guarantee that the imposed sanction would be pronounced, this institute has a rare occurrence in practice with the underlying effect of legal uncertainty. The second one and more represented concept is the "charge bargaininig", an indictment agreement between the state attorney and the defendant where the state attorney undertakes to alleviate the indictment (by abandoning the certain counts of the indictment or by changing the legal qualification of the offense)<sup>5</sup> in exchange for the defendant's acknowledgment of the commission of the "agreed" criminal offense.<sup>6</sup> The prosecution has its full freedom to define the legal qualification of the indictment in accordance with the principle of accusation and in accordance with a strict division of the mechanisms of the judicial authorities. The plea bargaining is conducted solely between the prosecutor and the defense attorney, while the court has no right nor the ability to influence the decision of the parties to conclude the agreement.<sup>7</sup> In such "plea bargaining" model, for a simpler, more efficient and fairer prediction of sanctions, which is ultimately always pronounced by the court, The United States Sentencing Commission,<sup>8</sup> as an independent judicial body, has issued punitive guidelines, Federal Sentencing Guidelines Manual, that allow the parties to predict the amount of punishment the court will pronounce, expressed in months (Tabel 1).<sup>9</sup>

*Table following on the next page*

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<sup>5</sup> Cf. Krstulović, A.; Nagodbe stranaka u suvremenom kaznenom postupku, Zagreb, 2007., p 37.

<sup>6</sup> For example, a defendant who raped a person may negotiate with the state attorney and, by changing the legal qualification of the offense, he might be sentenced for ordinary bodily injury insted. Example by Damaška M.; general quote, (number 1) p. 237.

<sup>7</sup> Cf. Tomičić, Z., Novokmet, A.; Nagodbe stranaka u kaznenom postupku– dostignuća i perspektive, Pravni vjesnik, god. 28., No. 3.-4., 2012., p. 165.

<sup>8</sup> The Commission, as an independent body within the judiciary, has been established with the primary purpose of establishing penal policy and practice for federal crimes for the purpose of securing the goals of the judiciary through the publication of detailed Federal Sentencing Guidelines Manual. Judges are not delighted with the Guidelines because they bind their hands and cause practical problems. Cf. Mrčela M. : Judgment at the Parties' Request for Investigation, Croatian Criminal Law and Practice Yearbook (Zagreb), Vol. 9, No 2/2002, p. 357-358.

<sup>9</sup> <https://www.ussc.gov/guidelines/2016-guidelines-manual/2016-chapter-5>

Table 1: Amount of punishment the court will pronounce expressed in months

SENTENCING TABLE (in months of imprisonment)						
Offense Level	Criminal History Category (Criminal History Points)					
	I (0 or 1)	II (2 or 3)	III (4, 5, 6)	IV (7, 8, 9)	V (10, 11, 12)	VI (13 or more)
Zone A	1	0-6	0-6	0-6	0-6	0-6
	2	0-6	0-6	0-6	0-6	1-7
	3	0-6	0-6	0-6	2-8	3-9
	4	0-6	0-6	2-8	4-10	6-12
	5	0-6	1-7	4-10	6-12	9-15
	6	0-6	2-8	6-12	9-15	12-18
	7	0-6	4-10	8-14	12-18	15-21
	8	0-6	6-12	10-16	15-21	18-24
Zone B	9	4-10	8-14	12-18	18-24	21-27
	10	6-12	10-16	15-21	21-27	24-30
	11	8-14	12-18	18-24	24-30	27-33
Zone C	12	10-16	15-21	21-27	27-33	30-37
	13	12-18	18-24	24-30	30-37	33-41
	14	15-21	21-27	27-33	33-41	37-46
Zone D	15	18-24	24-30	30-37	37-46	41-51
	16	21-27	27-33	33-41	41-51	46-57
	17	24-30	30-37	37-46	46-57	51-63
	18	27-33	33-41	41-51	51-63	57-71
	19	30-37	37-46	46-57	57-71	63-78
	20	33-41	41-51	51-63	63-78	70-87
	21	37-46	46-57	57-71	70-87	77-96
	22	41-51	51-63	63-78	77-96	84-105
	23	46-57	57-71	70-87	84-105	92-115
	24	51-63	63-78	77-96	92-115	100-125
	25	57-71	70-87	84-105	100-125	110-137
	26	63-78	78-97	92-115	110-137	120-150
	27	70-87	87-108	100-125	120-150	130-162
	28	78-97	97-121	110-137	130-162	140-175
	29	87-108	108-135	121-151	140-175	151-188
	30	97-121	121-151	135-168	151-188	168-210
	31	108-135	135-168	151-188	168-210	188-235
	32	121-151	151-188	168-210	188-235	210-262
	33	135-168	168-210	188-235	210-262	235-293
	34	151-188	188-235	210-262	235-293	262-327
	35	168-210	210-262	235-293	262-327	292-365
	36	188-235	235-293	262-327	292-365	324-405
	37	210-262	262-327	292-365	324-405	360-life
	38	235-293	292-365	324-405	360-life	360-life
	39	262-327	324-405	360-life	360-life	360-life
	40	292-365	360-life	360-life	360-life	360-life
	41	324-405	360-life	360-life	360-life	360-life
	42	360-life	360-life	360-life	360-life	360-life
	43	life	life	life	life	life

November 1, 2016

Source: <https://www.ussc.gov/guidelines/2016-guidelines-manual/2016-chapter-5>

Such a simple arrangement leaves a large maneuvering space for the prosecution, as the basic body of criminal procedure, guided by the final conviction in criminal proceedings, while diametrically opposed fulfills the principles of fairness, equality, economy and efficiency as the essential motive of strictly formalized criminal proceedings.

### 3. FORMAL SETTLEMENT IMPLEMENTATION IN CONTINENTAL LAW OBSERVED THROUGH THE LEGAL SYSTEMS OF GERMAN, FRANCE AND ITALIAN LEGAL DOCTRINE

For criminal justice systems of the Federal Republic of Germany, the Republic of France and the Italian Republic, as a leaders of introducing Anglo-Saxon elements into the continental legal system, through the prism of the party settlement, common is relatively late implementation of formal settlement into criminal proceedings. Such late introduction of formal settlements at the end of the 20th and early 21st century was preceded by covert agreement for trials of mild criminal offenses that, although socially dangerous and undesirable, represented a burden for



an efficient legal system that should focus its full capacity on evidentially complex and demanding cases.

### **3.1. Formal settlement in German criminal law doctrine**

In 2009, the Republic of Germany strictly formalized the court settlement by implementation through the legal text, that *de facto* existed for years as a result of practical action. The publication of an anonymous article by renowned attorney Hansa Dah Detlef Deal,<sup>10</sup> in which he described an informal and unlawful agreement in a strictly formal criminal procedure, prompted a heated discussion of, by then, unknown, legally unrecognized, and by legal theorist unforeseen phenomenon. The Act governing the Criminal Procedure Agreement<sup>11</sup> implements the provisions that concretize the negotiations through the active participation of three process subjects (court, state attorney and defendant), where in the case of defendant's plea guilty, the court determines the limits of special minimum and maximum of penalties, on which the parties give their stance. Defendant's plea guilty, does not relieve the court of its duty of determining all those facts and evidence relevant for making a fair decision, which is the remnant of a specific feature of the German criminal proceedings aimed at establishing material truth in the criminal proceedings. The settlement arises in the moment of parties agreeing (defendant and state attorney) with the proposal of the court. Courts tie to the settlement ends in the situations of oversight the legal and factual circumstances of the offense, ie. in case of the emergence of new circumstances as a result of which the sustainability of the settlement becomes inadequate. Strong involvement of a judge in the settlement process itself can be negatively reflected in the domain of its independence and impartiality, especially if the negotiations become unsuccessful. Valuable attention lies in the fact that German legislator didn't limit the possibility of strictly formal settlement to an individual stage of the criminal procedure, but left the possibility for the parties, with the assistance of the court, and after defendant pronounced its readiness, to conduct a strictly formal settlement at any stage of the criminal proceedings. According to the author's view, such an approach is a complete and correct solution to this problem.

### **3.2. Formal settlement in French criminal law doctrine**

The Republic of France had also made a relatively late full and strict formal implementation of the parties' agreement in criminal proceedings, in 2004 by the Criminal Procedure Code.<sup>12</sup> The court settlement is limited by the type of criminal offense and the sentence height, which was initially restricted by the height of the imprisonment sentence for up to five years, but was amendment in 2011 and raised to a maximum of ten years, for offenses defined as *delits* (offenses imposed by a minimum sentence of two months in prison up to a maximum imprisonment sentence of 10 years). The specificity of the French settlement lies in the court's homologation of a party's agreement, preceded by a public hearing, with court's broad powers of agreement refusal if it considers that the proposed sentence is inconsistent with the circumstances of the offense or the perpetrator's personal circumstances. The public hearing was introduced by amendments to the Criminal Procedure Code of 26 July 2005, as a correction of the original agreement approval that was arranged as *in camera*. This was the consequence of the Constitutional Council's decision<sup>13</sup> by which the proceedings *in camera*, when it comes to trials for criminal offenses punishable by imprisonment, declared unconstitutional and

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<sup>10</sup> Dachs, Hans, Absprachen im Strafprozess-Chancen und Risiken, Neue Zeitschrift für Strafrecht, No. 4/1988., p. 156.

<sup>11</sup> Bundesanzeiger No. 49/2009 from 3. August 2009.

<sup>12</sup> Amendments: Law no. 2005-847 of 26 July 2005, Law no. 2007- 291 of 5 March 2007, Law no. 2009-526 of 12 May 2009, Law no. 2011-1,862 of 13 December 2011, Law no. 2014-896 from August 15.

<sup>13</sup> Decision of the Constitutional Council, No. 2004-492 DC of 2 March 2004, paragraphs 117 and 118

contrary to the Declaration of Human Rights and Citizens from 1789.<sup>14</sup> Ministry of justice available data shows a continuous efficiency increase of the parties' agreement in the total number of criminal cases. Despite the excellent reports on the effectiveness of such a method of solving criminal proceedings, it is contemplating about re-limiting the specific mitigation to a time limit of three-years of imprisonment, with repealing of the maximum limit of one year, respectively half of the prescribed punishment for the proposed punishment.<sup>15</sup> The reason lies in the indicators of individual studies that show that the American plea bargaining has resulted in an increase number of innocent convicted persons to over 10%, and as a result of a large quantum difference between the offered and sanctioned sentence.<sup>16</sup> Comparative look at the German and French model, as two similar ways of strictly formal arrangement of settlement institute, can lead to conclusion that the legislator's intention has clearly predicted the strong role of the court in the process of ratifying a settlement through the implications of broad possibilities of refusing to enact a judgment under the parties' agreement, if considers that the amount of punishment is not adequate to the gravity of the criminal offense and for achieving the purpose of punishing and individualizing the sentence.

### 3.3. Formal settlement in Italian criminal law doctrine

Prior to all leading continental legal systems, the Republic of Italy had recognized the benefits of agreeing solving criminal proceedings in a strictly formal way, so in 1989, through the Criminal Procedure Code the possibility of reaching a party agreement, aimed at economical and efficient resolution of criminal proceedings, was implemented, through the institute "determination of the sentence at the parties request" (Application of the punishment at the parties' request).<sup>17</sup> By doing so, the Republic of Italy became the first continental Europe country to breakthrough the implementation of various accusation elements into criminal proceedings. The Italian legislator faced the difficult challenge of reconciling a new pragmatic, useful process instrument with firmly rooted Italian process principles. Compromise concession has resulted in the adoption of a new institute with certain modifications (the inadmissibility of settlement for the most serious criminal offenses, the benefits for the defendant have been linked to the law prescribed punishment relief and the judges have higher duties for checking the settlement than it is the case with Anglo-American legal systems).<sup>18</sup> Although inspired by American plea bargaining, retraining of the indictment or the abandonment of certain counts of the indictment, it is only possible with the substantive facts substrate. The agreement is limited by the type of offense and the perpetrator, as well as the amount of imprisonment, which reduced by one third of the sentence, must not exceed two respectively five years. That is, the possibility of concluding a settlement is excluded for criminal offences for which seven-and-a-half-year prison sentences is threatened. The negotiation is limited to the stage before the main hearing. A request for the application of the sentence at the parties request shall be submitted by the parties together or by one party with the consent of the other.<sup>19</sup> One-sided submission by the defendant requires the subsequent approval of the state attorney, otherwise the request will be rejected.

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<sup>14</sup> Declaration des Droits de l'Homme et du Citoyen od 26. kolovoza 1789., tekst na stranici <http://www.conseil-constitutionnel.fr/conseil-constitutionnel/francais/la-constitution/la-constitution-du-4-octobre-1958/declaration-des-droits-de-l-homme-et-du-citoyen-de-1789.5076.html> (Access 6. April 2018.)

<sup>15</sup> Cf. Turudić, I., Pavelin Borzić, T., Bujas, I.; Sporazum stranaka u kaznenom postupku – trgovina pravdom ili?, Pravni vjesnik, god. 32., Vol. 1., 2016., p. 130.

<sup>16</sup> Cf. Rakoff, Jed S., Why Innocent People Plead Guilty, The New York Review of Books, November 20, 2014 ISSUE; <http://www.nybooks.com/articles/2014/11/20/why-innocent-people-plead-guilty/>

<sup>17</sup> Informal name for the institute of determination of the sentence at the parties request is so called. *patteggiamento* -bargaining preceded by a party request.

<sup>18</sup> Cf. Damaška, M.: Sudbina anglo-američkih procesnih ideja u Italiji, Hrvatski ljetopis za kazneno pravo i praksu (Zagreb), vol. 13, No 1/2006, p. 7.

<sup>19</sup> Ma, Yue, Prosecutorial discretion and plea bargaining in the United States, France, Germany, and Italy: A comparative perspective, International Criminal Justice Review, vol. 12., No. 1/2002., p. 39.

By way of exception, a judge may comply with a defendant request if he considers that a state attorney omission to comply with a request is unfounded and reflects arbitrariness. The aforementioned judicial control over the decisions of the prosecution is carried out with the aim of preventing discrimination and affirmation of the principle of equality of citizens before the law. While the role of the court in the party negotiations is passive because it doesn't participate in them, after the agreement conclusion, the court, besides the legitimacy of the request, also examines the appropriateness of the proposed sentence, given the judge discretion to assess the appropriateness of the sentence unbound by parties choice of sentence.<sup>20</sup> Despite the pragmatic utility of shortening the procedure, the settlements are much less present in Italy than in the United States.<sup>21</sup> The aforementioned narrow comparative view of the settlement institute through the legislation of the Republic of Germany, France and Italy clearly implies that all three legislative solutions are based on the already tried and tested party settlements in the United States criminal procedure through a specific model of plea bargaining. It is also noticed that all three comparative solutions essentially retained the basic role of the court in affirming such agreement through a formal court judgment, ie. the court has left a broad possibility of refusing to approve the parties' agreement for reasons that would constitute a gross violation of the punishment suitability and ultimately guaranteed equality of parties in strictly formal court proceedings.

#### **4. CROATIAN LEGAL SYSTEM - FORMAL STRUCTURE OF THE INSTITUTE OF THE PLEA BARGAINING AGREEMENT AND AGREEMENT ON PUNISHMENT AND OTHER MEASURES**

In spite of the intense global interest for public actions efficiency, with the need of satisfying a formal legal aspects in each judicial process, especially in criminal proceedings, the Republic of Croatia has made a decisive step towards the implementation of the accusatory elements in mixed criminal proceedings through strictly formal court settlement, known as institute "Verdict on Plea Bargaining Agreements and the Agreement on Punishment and other Measures" implemented by the new Criminal Procedure Code (CPC) just in 2008. By such a regulation, the Republic of Croatia joined to continental legal systems who recognized the importance and possibility of solving criminal proceedings through the implementation of the institute of court settlement. The aforementioned solution is standardized in the CPC through Title XIX, Art. 361 to 364, and, as understood by the author, is a hybrid model of already existing and implemented institutes in criminal proceedings of the comparative legal systems (Germany, France and Italy) through the prism of the institute of formal court settlement in criminal proceedings. First of all, it is clear that through the influence of the model created and applied in the United States, and later introduced into the European continental legal system, the Republic of Croatia has chosen a legislative solution that is not exactly identical to none of the solutions mentioned, even though all inherits the same fundamental bases. Essential difference lies in the fact that plea bargaining agreement in criminal proceedings in the Republic of Croatia hasn't formally restricted by the type of criminal offenses, so it is possible to negotiate regardless the weight of criminal offence or the height of the proposed sentence, which results in very broad maneuvering space for the application of this institute.<sup>22</sup> The only limitations are criminal offenses against life and the body and against sexual freedom, for which a prison sentence of five years or more is prescribed, where the State Attorney has to obtain the victim consent in order to negotiate (Article 360, paragraph 6 of the CPC). Negotiations are usually initiated by a State Attorney, which is the result of his fundamental duties and powers, but

<sup>20</sup> Van Cleave, Rachel A., *An Offer You Can't Refuse? Punishment Without Trial in Italy and the United States: The Search for Truth and an Efficient Criminal Justice System*, Emory International Law Review, vol. 11, 1997., p. 446.

<sup>21</sup> Cf. Fabri, M.: *Theory versus Practice of Italian Criminal Justice reform*, vol. 77 *Judicature*, n. 4, 1994., 211, 213.

<sup>22</sup> Cf. *Kazneno procesno pravo* Primjerovnik, Bonačić M., Đurđević Z., Glušćoć S., Ivičević Karas E., Josipović I., Novoselec H., V. izmijenjeno i dopunjeno izdanje, Zagreb, listopad 2014., p. 126.

negotiations can be initiated by the defendant (or his defense attorney) as well. The precondition for negotiation is defendant's plea guilty while the subject is the height of the sentence within the legal framework. The ultimate goal for the defendant is mitigation of the sentence than would be imposed in ordinary course proceedings while for the state attorney it is efficiency of the criminal proceedings reaching the conviction. Since the court has no insight into the agreement between the state attorney and the defendant, and the parties are setting the parameters of the settlement, the court can only accept it or reject it. The wide-ranging legislative framework was attempted to be limited by the "Bargaining instructions on negotiating and agreeing with the defendant with the plea guilty and sanction" from 17 February 2010, passed by the State Attorney General, which had to accelerate the introduction of this complex institute into a living judicial organism. As an attachment to the Bargaining instructions, a summary study was added, based on a sample of 6500 final verdicts (Attachment no. O-2 / 09-1) which were supposed to serve as some kind of guidance in terms of expected and real sanctions.<sup>23</sup> This was considered as an attempt to limit the permitted legislative width both in terms of the height of the specific mitigation of the sentence imposed and in respect of the types of criminal offenses for which agreement is possible. However, giving specific instructions on the type of sanctions for a particular type of criminal offense was failed due to the large differences in the imposed sanctions. One of the shortcomings of the legislative arrangement of the institute „Verdict on the Plea Agreement and Penalty and other Measures Agreements" is prosecutions' inertia to enter into negotiations with the defendant, despite the explicit legal obligation of the state attorney to negotiate on the plea guilty and punishment and other measures for *ex officio* prosecutions. Such a discretionary assessment of the prosecution body, to act unprincipled opens up the possibility of discrimination in certain cases which, according to the author of this paper, is not in accordance with the constitutionally proclaimed principle of equality. The only restriction for reaching a plea guilty agreement, which is essentially and formally introduced in the legal text, is a procedural phase limitation to which the formal recognition of plea guilty agreement is possible to reach. Such a limitation is legally defined as a moment of indictment exposure by prosecution, ie. the beginning of the preparatory hearing. By the author's point of view, precisely this process restriction leaves the possibility of a subsequent covert informal settlement which, by itself, regardless of its effectiveness, should not be outside the legal text, or outside the strict formal provisions of the CPC.

## **5. THE APPEARANCE OF UNFORMAL PLEA GUILTY AGREEMENT THROUGHOUT THE STATISTICS OF THE MUNICIPAL COURT IN SPLIT FINAL JUDGMENTS WITHOUT THE APPEALING EITHER FROM THE DEFENDANT NOR THE STATE ATTORNEY**

Analyzing the very model of the legal solution in the Croatian legal system, in the previous chapter of this paper, regarding the plea guilty agreement, logically imposes a critical thinking on all the shortcomings of this institute, for what the author has already concluded is a hybrid model that's not identical copy of any existing legal solutions of the states that inherit the continental legal doctrine. By approaching such a critical review and analyzing jurisprudence on a relatively large sample of 2,734 final decisions, in the observed period from 1 April 2014 to 31 December 2017, on the concrete statistical data of the Municipal Court in Split, as the second largest court in the Republic of Croatia, it is clear that several important conclusions can be made. First, from the data and the diagram share of the Municipal Court in Split final verdicts it is apparent that for the aforementioned period from April 1, 2014 to December 31, 2017, out of a total of 2,734 final cases, 1,846 criminal cases of the basic mark K and Kmp and 58 criminal cases of the basic mark Kzd became final with no appeals, neither the prosecution or defense, which, undoubtedly points to a disguised or informal agreement.

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<sup>23</sup> Cf. Turudić i dr., op. cit. (note 15), p. 141.

Second, the emergence of informal settlement is well rooted into the parties relations who are, in their purely procedural positions, opposed, so it is undeniable that such informal agreement is happening. The scenario of such informal agreement implies informal and non-binding negotiations of the defendant, that is, his defense with the prosecution. In such negotiations, the parties, who have already proceeded the evidentiary proceedings, with more or less success, in such informal negotiations are presenting and analyzing their procedural position by trying to predict the stance of the First Instance Court and ultimately the outcome of the appeals process. After reaching an informal agreement between the defense and the prosecution (because the possibility of formal settlement and reaching the verdict is legally limited to the phase of indictment exposure), such consentaneous proposal for sanction and plea guilty is presented to the court, that is generally not interested in the type or amount of the sanction, but primary motivated by properly filled form to which the relevant court proceedings will be completed and become final, without appeals being reviewed by the higher courts. It is very difficult to expect the first-instance judge to try to divert defendant from plea guilty and agreeing on sanction, even if it is in contravention with his personal conviction, because our judicial system is burdened with obligations to fill the prescribed forms and norms in order to maintain a high level of conscientiously performing the judicial function. Thus, in the informal procedure described above, by all the actors of strictly formal court proceedings, a latent abandonment of the basic doctrine of continental legal heritage is reflected, that is seeking of material truth as the basis of justice. According to the author's standpoint, such a substitution of the pole is result of collision of the syncretism of seeking material truth and focus on the effectiveness of criminal proceedings as the ultimate goal.

## 6. CONCLUSION

Anglo-American legal reality rests on firmer stronghold in terms of the existence of a parties negotiations than Continental legal doctrine does. The main critique addressed to the parties negotiations is skipping a significant step, a phase of discussion, thereby losing judiciary transparency and making judicial control harder. Although parties negotiations (plea bargaining) are irreconcilable with a series of criminal procedural principles, yet they lead to radical simplification of the criminal proceedings, whereby pragmatic arguments gaining importance and process mechanisms, that facilitate justice work, become more attractive. The strongest pragmatic instruments that favored the parties negotiations are the judiciary overload and limited available capacities that require rational use of the judicial means. A court procedure that strives to achieve more efficient and economical way of ending criminal procedure, as an ultimate goal, can't simultaneously satisfy the need for maximum determination of material truth. However, accepting a settlement without detailed scrutiny has a repercussion of superficial ratification of party settlement. The widespread use of the institute of negotiation/settlement in criminal proceedings is consequence of the penetration of accusatory elements into a continental legal doctrine. While dominant purpose of punishment becomes reparation and special prevention, the impulse of retribution falls far behind. The Republic of Croatia has also responded to the intense global interest for effectiveness of public actions through the formal judicial settlement implementation by Criminal Procedure Code provisions, known as "Verdict on Plea Bargaining Agreements and the Agreement on Punishment and other Measures". This model can be considered as hybrid of existing solutions in comparative legislation, since our legislator didn't restrict the possibility of the settlement institute to the type of offense or the height of imposed sentence. The only formal constraint is reflected through the restriction at a certain stage of the process, to which negotiation is possible. Despite this limitation, the institute of settlement has been integrated into the criminal procedure and exists through the informal, out of court settlement, beyond the limits of the restriction, as evidenced by its appearances in practice.

A review of the fact that from 2,734 final cases in the period from April 1, 2014 to December 31, 2017, 69.64 % cases had ended final without parties' appealings, clearly implies that, within this percentage, procedures terminated by the parties' settlement, after the indictment exposure phase, are hidden, which implicitly suggests that it is a dark number that the legislator should pay attention to. Existing arrangement, according to which the ability of reaching a formal settlement is limited to the indictment exposure stage, should be modify and extend at all stages of criminal proceedings, analogous to the legal arrangements of the german legislator. Also, despite of decisive legal authority and obligation of the state attorney to enter into negotiations with the defendant when prosecute criminal offenses ex officio, the question is what is to be done in the cases when state attorney has no negotiating affinities, since there is no sanction for state attorneys' inertness and indifference to access negotiations. To conclude, such an alternative way, as the fastest and easiest way of resolving disputes, requires a thorough analysis of all comparative and inconsistent variables in the broader spectrum, since it has been 10 years since the CPC/08 was brought, whereby the analysis shouldn't depart from the fundamental principle of legality (of criminal persecution), opportunity and individualization of punishment.

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# INDEPENDENCE AND IMPARTIALITY OF EXPERT WITNESSES IN PROCEEDINGS DAMAGES FOR MEDICAL NEGLIGENCE IN THE LIGHT OF PRACTICE OF THE EUROPEAN COURT OF HUMAN RIGHTS

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## ABSTRACT

*Case law of the European Court of Human Rights (ECHR) is a significant source of legal responsibility for medical personnel. Pursuant to the Convention on the Protection of Human Rights and Fundamental Freedoms, the State has a duty to ensure the proper implementation of the legislative and administrative framework established for the protection of the rights of the patient and must also ensure responsibility for negligence in the field of health care. States have a positive obligation to adopt regulations that oblige public and private health institutions to adopt appropriate measures to protect the life and physical integrity of their patients and also must provide victims of medical negligence with access to compensation procedures. Thus, states must provide patients with an effective and independent judicial system (criminal/civil) for compensation for damage due to negligent treatment. The responsibility for a medical error can only be determined by the court with the aid of independent and impartial opinions of medical experts. As the expert witnesses of the medical profession are at the same time part of the same public health system, the issue of their impartiality and independence and the existence of appropriate procedural guarantees in domestic law is raised. Especially due to complaints that the concept of medical errors and medical negligence is not appropriately defined in the Croatian legal system and a number of difficulties in determining whether an action/omission of health workers caused harmful consequences for the patient (death, bodily injury or impairment of health). Therefore, one of the important standards of fair trial is to provide formal and factual independence and impartiality of expertise that play a key role in assessing the very complex issues of non-cure treatment. The standards expressed in the decisions of the ECHR require an independent judicial system to ensure adequate compensation in criminal and/or civil proceedings which must be effective in practice and be carried out without undue delay.*

**Keywords:** *damage compensation, effective investigation, expert witnesses, fair trial, medical negligence*

## 1. INTRODUCTION

Modern legal systems provide patients civil protection, separate from or together with criminal law protection, by establishing the responsibility of a health worker and civil liability in the form of material damages or damages for breaches of personality rights or publication of decisions, and disciplinary measures which may also be envisaged.<sup>1</sup> States have a positive obligation to allow victims of medical negligence access to data for compensation of damage i.e. an effective and independent judicial system (criminal/civil) to compensate damage for negligent treatment. There is a particular emphasis on the need to identify the causes of deaths of persons under the protection and responsibility of health professionals and there is an obligation to establish an effective judicial system for determining the causes of death in

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<sup>1</sup> Conclusion in the judgments *Vo v. France*, *Calvelli & Ciglio v. Italy*, *Lazzarini & Ghiacci v. Italy*, *Mastromatteo v. Italy*, *Tarariyeva v. Russia*. Batistić Kos, p. 151.



hospitals.<sup>2</sup> In other words, the right to life poses a state and procedural obligation to conduct an effective and rapid investigation into the circumstances of the patient's death. All procedures must not only be theoretically but practically effective, which implies the possibility of effective medical examinations of all relevant issues both in criminal and compensation procedure. For EU legislation in the area of medical staff responsibility, this is an important attempt to harmonize the legal rules on the civil liability of physicians and other health workers. Namely, in 1990, the proposal of the Council of Europe guidelines on service liability was drafted. The proposal foresees that all executors or service providers, including doctors, are responsible for the damage caused by their erroneous services according to the guilty plea principle. However, the great opponents of these guidelines were German lawyers who felt that accountability based on guilt was not adequate for medical services. Also, the European Committee on Legal Co-operation, at the request of the European Health Committee and the European Committee on Bioethics, produced a report on the state of medical accountability in Council of Europe countries, which raised the issue of the need to adopt a new instrument for the unification of European practice in the field of professional obligations and the standards and / or the right to fair compensation in the case of malpractice. Harmonization is not possible for now because of significant differences in the burden of proof, causality and the process itself.<sup>3</sup> However, harmonization standards are also achieved through the decisions and interpretations of the ECHR in this area. Since 2012, the ECHR has brought three judgments in proceedings against Croatia in which it found a violation of the right to life due to omission of procedural obligation because it found that the competent authorities did not undertake an effective and rapid investigation into the circumstances of the death of patient. These are cases *Bajić v. Croatia*,<sup>4</sup> *Kudra v. Croatia*<sup>5</sup> and *Bilbija & Blažević v. Croatia*<sup>6</sup> where a violation of rights occurred mainly due to the length of proceedings. In the case of *Bajić v. Croatia* a violation of the right to life was found for failure to satisfy the conditions of independence of the proceedings regarding the expert's objectivity, but also because the criminal proceedings lasted for almost fifteen years. In the case of *Kudra v. Croatia* the violation of the right to life was established because of the long duration of civil proceedings for compensation of damage (the procedure started in October 1993, and the final judgment was in February 2006) while in the *Bilbija & Blažević v. Croatia* case a violation of the right to life was found due to the length of disciplinary proceedings (eleven years) and criminal proceedings (nine years).<sup>7</sup> In the most recent decisions in the case of *Jurica v. Croatia*<sup>8</sup> and *Letinčić v. Croatia*,<sup>9</sup> ECHR discussed the violation of the right to a fair trial due to suspicions of the independence and impartiality of medical experts in litigation for compensation for damage due to medical error. In this paper which standards are considered crucial for the objectivity of the findings and opinions of medical experts will be analyzed and the decision in the case of *Jurica v. Croatia* will be displayed.

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<sup>2</sup> About the procedural obligation to determine the cause of death and responsibility for medical negligence see *Powell v. United Kingdom*, appl. no. 45305/99, ECHR 2000-V, *Vo v. France*, judgment 8.7.2004, § 89, *Calvelli i Cigliio v. Italy*, appl. no. 32967/96, judgment 17.1.2002. i *Trocilier v. France*, app. no. 75725/01, judgment 2006. *Benderskiy v. Ukraine*, no. 22750/02, §§ 61-62, 15.11.2007; *Codarcea v. Romania*, no. 31675/04, §§ 102-03, 2.6.2009; *Yardımcı v. Turkey*, no. 25266/05, §§ 55-57, 5.1.2010; *Spyra and Kranczkowski v. Poland*, no. 19764/07, §§ 82 and 86-87, 25.9.2012; *Csoma*, cited above, §§ 41 and 43; and *S.B. v. Romania*, no. 24453/04, §§ 65-66, 23.9.2014). Premelč, p. 22

<sup>3</sup> In this regard both of them emphasize the importance of medical responsibility for patient rights, good medical practice and the reduction of health care costs. Turković, p. 12.

<sup>4</sup> App. No. 41108/2010, judgment 13.11.2012.

<sup>5</sup> App. No. 13904/2007, judgment 18.12.2012.

<sup>6</sup> App. No. 62870/2013, judgment 12.1.2016.

<sup>7</sup> See case of *Byrzykowski protiv Poland*. More Kušan, p. 297.

<sup>8</sup> *Case of Jurica v. Croatia*, application no. 30376/13, judgment 2.5. 2017 (Final 02/08/2017).

<sup>9</sup> *Case of Letinčić v. Croatia*, appl. no. 7183/11, judgment 3.5.2016.

## 2. ECHR DECISIONS CONCERNING VIOLATION OF THE RIGHT TO A FAIR TRIAL IN CASE OF JURICA V. CROATIA

The most recent verdict from 2017 in the case of Jurica v. Croatia refers to the issue of objectivity in establishing medical negligence and the independence and impartiality of medical experts in accordance with the requirements contained in article 6§1 and 8. of the Convention.<sup>10</sup>

### 2.1. The facts – the circumstances of the case

The applicant G. J. was operated on in 1989 and, despite continued treatment until 1997, due to the paralysis of the left side of her face, she went into early retirement due to disability. In 1998 the applicant lodged a civil action against the hospital and the relevant insurance company with the Zagreb Municipal Civil Court claiming damages for alleged medical malpractice. In 2000 a hearing was held at which the Zagreb Municipal Civil Court decided to commission an expert report concerning the circumstances of the applicant's treatment by experts R.T. and P.S. P.S. produced a report in which he stated that he had found no indications of medical malpractice in the applicant's treatment while R.T. asked to be excluded from the proceedings on the grounds that he was employed in the hospital and that therefore an issue as to his impartiality could arise. In 2001 the Zagreb Municipal Civil Court found that it was necessary to commission another expert report from the University of Zagreb Medical Faculty concerning the question of whether the applicant's condition was a result of medical negligence. The University of Zagreb Medical Faculty produced a report in 2005 which found that the applicant's facial paralysis was the result of complications during surgery and not medical malpractice. Then, the applicant specified her claim, arguing that the report established a causal connection between the surgery and the deterioration of her health. She also considered that according to the principle of objective liability, the hospital was responsible. In 2009 the Zagreb Municipal Civil Court commissioned another expert report from D.V. with regard to the question of a causal link between the applicant's condition and her disability pension in which the expert found that there was a direct causal link between the applicant's condition and her retirement on grounds of disability. In 2010 the applicant asked that experts from another European Union State be appointed as expert witnesses in her case but the Zagreb Municipal Civil Court dismissed that request and concluded the hearing. Also, the applicant challenged the impartiality of the expert witnesses from Croatia, arguing that it was clear from the negligible number of cases where medical malpractice had been established that they were biased in favor of the defendants. The Zagreb Municipal Civil Court in 2010 dismissed the applicant's civil action, holding that in the case at issue the principle of presumed fault should be applied. That meant that it was up to the defendants to show that the hospital had acted in accordance with professional standards and that the damage was not the result of a lack of diligence on the part of the doctor who had performed the surgery. Relying on a detailed assessment of the expert reports obtained during the proceedings, the court found that on the facts of the case, the deterioration of the applicant's health had been the result of complications in the treatment and not of medical malpractice. It also pointed out that there was no doubt about the quality of the expert reports commissioned during the proceedings and that the applicant's request that another expert report be commissioned from abroad would unnecessarily further prolong the proceedings and generate further expense. The applicant appealed against that judgment before the Zagreb County Court alleging, inter alia, that the

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<sup>10</sup> Article 6§1 of the European Convention on Human Rights states: „In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law.“ Article 8 Right to respect for private and family life states: „(1) Everyone has the right to respect for his private and family life, his home and his correspondence. (2) 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.“

medical experts who had drafted the reports had a personal and professional conflict of interest in the proceedings, as they involved allegations of malpractice against their colleagues and the experts were financially dependent on the hospital system. In 2010 the Zagreb County Court dismissed the applicant's appeal as unfounded on the grounds that there was no reason to doubt the quality and findings of the expert reports. The applicant lodged an appeal on points of law with the Supreme Court reiterating her previous arguments concerning lack of impartiality on the part of the experts and the quality of the expert reports commissioned during the proceedings. The Supreme Court dismissed the applicant's appeal. The applicant lodged in 2012 a constitutional complaint before the Constitutional Court complaining of lack of an effective procedure before the competent civil courts to deal with her allegations of medical negligence. She also reiterated her complaints as to the lack of impartiality of the medical experts, arguing that the relevant statistics showed that it had been impossible to establish her allegations of medical negligence on the basis of the expert reports commissioned from the domestic experts. The Constitutional Court declared the applicant's constitutional complaint inadmissible as manifestly ill-founded. The applicant lodged with the ECHR a claim in 2013 for breach of Articles 6 and 8 of the Convention due to the lack of effective domestic proceedings, as it was impossible in Croatia to provide an independent and impartial finding and opinion of the expert on the issue of malpractice treatment, since all the relevant experts worked with those who were suspected of malpractice. Moreover, in view of the inadequate legal framework, she claimed that the expert finding on the differences between malpractice and complications during treatment could never be sufficiently conclusive. She then complained that there was no doubt that her disability was caused by medical malpractice during surgery, but because of omission in the domestic procedure nobody had been found responsible for her condition.

## 2.2. Violation of the right to access to court

Article 6. 1. of the Convention embodies the „right to a court” one form of which represents the right to access to a court. Given that the applicant claimed that the concept of malpractice was not properly defined in the Croatian legal system and therefore it was not possible to determine the liability for malpractice by a court decision, the ECHR did not accept that there is no proper legal framework in the domestic system for investigating allegations of malpractice. Due to the lack of official statistics on cases of civil proceedings for compensation for damage due to medical negligence in Croatia the applicant, of course, unjustifiably, concluded that the Croatian legal system does not establish any responsibility for medical errors at all. According to Article 8 of the Convention, the States have a positive obligation to allow victims of malpractice access to procedures where they can be compensated.<sup>11</sup> That such a procedure in Croatia does not exist only in theory but is also effective in practice<sup>12</sup> arises not only from the relevant domestic legislation which prescribes civil and criminal liability for medical negligence or malpractice but also from the relevant practice of Croatian courts. Civil responsibility is based on the Civil Obligations Act<sup>13</sup> as well as the complete codification of the standards and principles of professional responsibility of the physician for the malpractice.<sup>14</sup>

<sup>11</sup> See *Trocellier v. France*, *Benderskiy v. Ukraine*, no. 22750/02, §§ 61-62, 15.11.2007; *Codarcea v. Romania*, no. 31675/04, §§ 102-03, 2.6.2009; *Yardımcı v. Turkey*, no. 25266/05, §§ 55-57, 5.11.2010; *Spyra and Kranczkowski v. Poland*, no. 19764/07, §§ 82 and 86-87, 25.9.2012; *Csoma v. Romania*, no. 8759/05, § 43, 15.1.2013 §§ 41 and 43 and *S.B. v. Romania*, no. 24453/04, §§ 65-66, 23.9.2014.

<sup>12</sup> See *Gecekuşu v. Turska*, no. 28870/05, 25.5.2010. and *Spyra and Kranczkowski v. Poland*, no. 19764/07, §§ 88, 25.9.2012.

<sup>13</sup> Civil Obligations Act, Official Gazette no. 35/05., 41/08., 125/11., 78/15. The relevant part of the Civil Obligations Act: Section 1046 “Damage is ... infringement of the right to respect for one's personal dignity (non-pecuniary damage).” Request to desist from a violating personal integrity Section 1048 “Anyone may request a court or other competent authority to order the cessation of an activity which violates his or her personal integrity and the elimination of its consequences.”

<sup>14</sup> Patients' Rights Act, Health Care Act and Medical Professions Act. See *M.S. v. Croatia* (no. 2), no. 75450/12, §§ 37.-39., 19.2.2015. and *Bilbija & Blažević v. Croatia*, §§ 78.

Medical malpractice is defined as criminal offence under the Criminal Code<sup>15</sup> and can be committed by any health worker who, by performing a healthcare activity, uses a clearly inappropriate means or method of treatment or otherwise obviously fails to comply with the rules of the health profession or manifestly acts maliciously, thereby causing the deterioration of the illness or the disturbance of the health of another person. Also, in practice, the Supreme Court of the Republic of Croatia and the Constitutional Court of the Republic of Croatia have developed appropriate standards under which civil liability for medical malpractice exists if the health institution acted contrary to the rules of the health profession and thus caused damage to health. Determining a harmful action is a prerequisite for distinguishing a medical error from complications or unwanted treatment outcomes. Thus, the most important harmful actions and omissions in providing health services can be categorized into four groups: 1. violation of the rules of health profession (medical error); 2. violation of the right to physical integrity (treatment without consent of the patient); 3. violation of the obligation to provide emergency medical assistance and 4. violation of the obligation to conclude a health service contract.<sup>16</sup> Although in the legal literature we find different definitions of medical error,<sup>17</sup> from all the provisions of the so-called health regulations<sup>18</sup> for this term we can say that this is the opposite act (not compliance with) rules and methods or standards of health profession and / or scientific knowledge, which endangers human life and health and / or disrespect of the moral and ethical principles of health profession.<sup>19</sup> Such responsibility is based on the principle of fault. Although, in the particular circumstances of a case, depending on the nature of the treatment, it may also be based on the principle of objective liability.<sup>20</sup> The risk that carries each medical procedure and which cannot lead to a causal connection with the mistake in the treatment can be a medical complication that is legally labeled as a case (*casus*). The relevant practice of Croatian courts regarding the determination of civil liability for malpractice accepts this notion of medical negligence. The ECHR conclusion, therefore, is that in Croatia compensation for medical malpractice can be claimed on the basis of a criminal or civil law, and hence, cannot conclude that seeking compensation for medical malpractice in Croatia is a possibility that exists only in theory,<sup>21</sup> so in this case the right to a fair trial was not violated.

### 2.3. Violation of the right to procedural equality (equality of arms)

The principle of equality of arms, which is one of the elements of the broader concept of a fair hearing, requires each party to be given a reasonable opportunity to present its case under conditions that do not place it at a substantial disadvantage vis-à-vis its opponent. The ECHR in case of *Letinčić v. Croatia* decided there was the violation of article 6.1. of the Convention because the judicial body, which was fully competent to examine all the factual and legal issues that arise in the context of the case, did not critically approach and remove the procedural

<sup>15</sup> Section 181. Criminal Code, Official Gazette nos. 125/11, 144/12, 56/15, 61/15, 101/17. In legal theory, especially Anglo-American, is a large number of those who give a reasons why civil responsibility should ultimately be the only legal way to deal with cases of medical negligence. Barcus, A. H. (2010).

<sup>16</sup> Klarić (2007), p. 12.

<sup>17</sup> The definition used in expertises and court proceedings is: „a mistake signifies the fact that in the concrete case something happened due to which the medical procedure (operation) was not completed in the planned manner so there was a damage to the patient's health.“ The event itself, however, does not prejudice any possible liability for the adverse consequence. Quoted Zečević, Škavić, pp. 6.. Klarić believes that from the point of view of legal terminology it is certainly a euphemism to call violation of the rule a mistake, especially when it comes to rules that enjoy legal sanction. Klarić (2003), p. 398.

<sup>18</sup> For example: Health Care Act, Patient's Rights Act, Medical Profession Act, Dental Care Services Act, The Medical-biochemical Activities Act, The Law on Transplantation of Human Organs for Therapeutic Purposes etc.

<sup>19</sup> Crnić, p. 51. Most foreign authors define medical error as neglect or deviation from the medical standard or the standard of medical science or as any measure that is according to the standard of medical science and experience carried out without due attention. These definitions emphasized the objective element or deviation from the standard of medical science while the violation of the obligation of due attention is a subjective element by which continues the old dispute over whether the concept of medical error should include an element of guilt. More: Klarić (2001), p. 12.

<sup>20</sup> See the Decision of the Constitutional Court in the case No. U-III-1062/2005.

<sup>21</sup> See *Jurica v. Croatia*, §§ 90.-92.

omissions relating to the exclusion of the applicant from the procedure of seeking and obtaining the opinion of expert witness. Namely, the applicant did not have the opportunity, as envisaged in domestic law, to find out and comment on the documents considered by the experts nor did he have the opportunity to examine the witnesses who made statements relevant for the experts report which resulted in a violation of the principle of equality of the parties, which is the element of a fair trial.<sup>22</sup> Also the applicant in the case of *Korošec v. Slovenia*<sup>23</sup> argued that the court had violated his right to a fair trial by basing his decision on the Commission's opinions, thus grossly violated the “principle of equality of arms” since the Disability Committees are not an independent body and members are appointed by the opposing party in the proceedings, and why there are legitimate reasons to suppose that the commissions did not act impartially.<sup>24</sup> The Court reiterated that in the case of *Sara Lind Eggertsdóttir v. Iceland*<sup>25</sup> it found that there had been a violation of article 6 § 1 of the Convention for not respecting the principle of “equality of arms” taking into account three factors: (1) The nature of the assignment entrusted to the expert; (2) Position of the expert in the hierarchy of the opposite side; and (3) The role of the expert in the procedure and especially significance which court was given to their opinion.

#### **2.4. Violation of the right to independence and impartiality in the trial**

The legal standards of causality, illegality and guilty in civil procedure/lawsuits for compensation for damage due to medical negligence are determined by the rules and criteria of medicine, with the use of experts’ reports because the courts do not have the necessary knowledge to evaluate meritorious questions.<sup>26</sup> The expert’s report<sup>27</sup> must provide answers to the question of whether there is a violation of generally accepted medical profession rules and in the case of determining medical error, about the circumstances to be taken into account by courts in determining the level of remuneration, relating to the length and intensity of pain, fear, degree of injury and the percentage of reduction in life activities (increased efforts). Croatian Courts most often entrust expertise to institutions such as medical faculties, specialized laboratories, etc. Given the deficit of the number of court experts in areas for which specific knowledge is sought, the courts are increasingly resorting to experts (especially institutions) from the region and when Croatia joined the EU, all the prerequisites for usage of experts from these countries were acquired.<sup>28</sup> Thus, medical experts have a special role in litigations involving medical negligence/malpractice because their reports by the nature of things are crucial to the judgment of the court on very complex issues of medical malpractice and other torts. The impartiality and expertise of a physician participating as a court expert is one of the *conditio sine qua non* of fair conduct of proceedings, both criminal and civil. Therefore, as regards the objectivity of proceedings of medical experts, ECHR requires that the proceedings must ensure the independence of expert’s reports. So, experts must be both formally and truly independent of those who allegedly participated in the controversial events and there must not be any hierarchical or institutional link between the expert and the person whose alleged responsibility decides.<sup>29</sup> Thus, in the case of *Bajić v. Croatia*, the ECHR found a violation of the right to life because of the manner in which the criminal procedure was conducted for the

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<sup>22</sup> See *Letinčić v. Croatia*, §§ 65-68.

<sup>23</sup> Case of *Korošec v. Slovenia*, appl. no. 77212/12, judgment 8.10. 2015 (final 08/01/2016).

<sup>24</sup> See *Korošec v. Slovenia*, §§ 46.

<sup>25</sup> Case of *Sara Lind Eggertsdóttir v. Iceland*, appl.no. 31930/04, 5.7. 2007, § 47

<sup>26</sup> Testimony by a physician as an expert is important in a large number of cases but sometimes the court can get that knowledge by insight into at medical documentation *Mujović-Zornić*, p. 398.

<sup>27</sup> The finding is a part of the expert's report in which the expert on the basis of his / her own special knowledge determines the changes that a certain fact has left in the outside world while the opinion is the part of the report in which the expert, on the basis of his reports and his professional knowledge, expresses his understanding of the meaning of the traces which the facts have left in the outside world.

<sup>28</sup> *Mađarić*, p. 324.

<sup>29</sup> *Kušan*, p. 296.

death of the patient allegedly caused by medical malpractice. Three expert witnessings were conducted in the procedure: first was carried out by two physicians from the Faculty of Medicine in Zagreb, secondly physician from the Faculty of Medicine in Rijeka and thirdly two physicians from the Faculty of Medicine in Zagreb. The defendant also worked at the Faculty of Medicine in Zagreb and one of the experts worked in the same hospital as the defendant. The decision of the criminal court was based solely on the report of expert of the Faculty of Medicine in Zagreb. Therefore, the ECHR found a violation of the right to life, concluding that here is not important the content of medical findings and opinions nor the question whether the applicant's sister really died because of medical malpractice but on the fact that the medical experts in the proceedings were professors at the same faculty as the defendant and according to Croatian law that they could not be considered objectively impartial. Namely, according to Art. 250 of the Criminal Procedure Act which then was applicable, the reason for the expert's exemption is also relation to a person who, together with the defendant or the injured party, is employed in the same state body or with the same employer.<sup>30</sup> In other words, it is about the question of the impartiality of the experts, their readiness to overcome the constraints imposed by "professional solidarity," "collegiality" and the exposure to the ability to find themselves in the situation of the person whose work will be evaluated and etc.<sup>31</sup> The problem is sometimes referred to as a "conspiracy of silence" which leads to the fact that it is very difficult to obtain a professional medical expert's opinion in the case of accusation and/or lawsuits against the health care worker for his malpractice.<sup>32</sup> Therefore the appointment of an impartial and professional physician-expert would facilitate the process of proofing and would prevent the appointment of more experts in the same procedure until the subject of the expertise is clarified completely and would prevent the possibility of abolishing judgments from the side of second instance courts and restitution of the case for retrial due to the erroneously established factual situation.<sup>33</sup> Thus, the court relieved an already nominated expert of duties after the expert informed the court that he had completed his specialization with the defendant and that he had worked with the defendant, and therefore he was not able to objectively conduct the expert witnessing.<sup>34</sup> Since the applicant in the case of *Jurica v. Croatia* claimed that due to the lack of impartiality of the medical profession expert, the right to a fair trial had been violated, the ECHR found that the role and the duties of the experts in the Croatian civil proceedings are legislatively regulated by Articles 251-262. Civil Procedure Act.<sup>35</sup> The court conducting the proceedings is competent to commission the report of the expert and before that it is obliged to hear the parties regarding the selection of the expert (section 251). An expert report is principally commissioned from a permanent court expert but a report may be commissioned from an institution (including a public institution such as a university) and if the matter at issue concerns specific and complex professional questions, the report must be primarily

<sup>30</sup> See *Bajić v. Croatia*, §§ 98.

<sup>31</sup> Opinion by prof. Dika according Čizmić, p. 693.

<sup>32</sup> Stason, p. 564.

<sup>33</sup> Although many patients in court proceedings are often called on "medical lobbies" and experts whose professional opinions go hand in hand with doctors, lawyer J. Mađarić thinks there are exist other side of medals: „While patients are most afraid of it "a crow doesn't pick out another crow's eyes" " and physicians criticise experts for being unobjective and taking the side of patients. I believe that both exist, but physicians more protect than 'bury' themselves.. It is questionable only whether the expert is prepared to answer the crucial question: whether, according to the prevailing stance of the medical profession, a colleague's procedure is in accordance with rules of the medical profession or not.. For that it must, firstly, rule over the waist, and secondly, must be so "objective" to write that to court and defend it towards from attack of another's opinion. Often the expertise is repeated and the expert's conclusions can be diametrically opposed. That is why our courts are sometimes forced to work with the experts from abroad most often it is the Faculty of Medicine in Ljubljana and the Universities in Vienna and Graz, which regarding prices are not significantly more expensive than domestic. By joining the European Union, the use of foreign experts will be more frequent, which is not bad. For, the main argument of some expertises is approximate: „I think so and so, I am one of the few experts in Croatia for this issue, so I'm in right. Competition is only welcome in this regard.“ Nacional, no. 700, April, 14 2009.

<sup>34</sup> The judgment of the Municipal Civil Court in Zagreb, reference number 5-Pn-5117/12-35. from November 10, 2015.

<sup>35</sup> Official Gazette 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

commissioned from a specialist institution (section 252). The provisions on the disqualification of judges are applicable mutatis mutandis to the disqualification of experts (section 254-255).<sup>36</sup> Court experts are required to provide their opinions objectively, impartially and to the best of their knowledge and they are also informed of the legal consequences of perjury (section 258). The expert has to provide a reasoned opinion either in the form of a written report or orally at the hearing, depending on the instruction of the judge conducting the proceedings. If the expert fails to meet those requirements, he or she can be questioned again concerning the particular issues, or another expert report may be commissioned from the same or a different expert. In each case, however, the expert opinion must be subjected to adversarial argument by the parties and examination by the competent court (section 259-261). Normatively the position of court experts is determined and by the Court Experts Ordinance, particularly as regards their appointment and general legal and professional obligations. Under the Ordinance a court expert in a particular field may be any person possessing the appropriate professional expertise and level of education. Legal persons may be appointed as competent institutions for expertise if they have registered such a business activity in the register of companies and if they employ permanent court experts. Therefore, since the regulations contain detailed rules on involving the parties in the process of seeking and obtaining reports of experts as well as the way in which the reports of experts are examined, the applicant failed to prove that all protective measures had not been properly applied and that the experts did not have the necessary objectivity. Namely it is very important is that the participation of an expert in the proceedings is accompanied with adequate procedural safeguards which securing their formal and de facto independence and impartiality. Croatian procedural law provides for several safeguards to ensure the reliability evidence of expert witness. Thus, one of the experts, initially designated to make the finding and opinion was excluded because he was employed in the defendant's hospital.<sup>37</sup> Furthermore, the court did not merely acknowledge written findings and opinions drawn up by expert witnesses, but also heard them publicly before the court, in the presence of the parties that could ask questions. The court ordered several additional findings and opinions and new findings and opinions from new experts order to further clarify the points that were left unclear or disputed.<sup>38</sup> Also, the objectivity of findings and expert's opinions in the case of malpractice cannot be automatically brought into question because of the fact that experts are physicians working in the domestic health system. The fact that an expert is employed in a public health institution designated to produce findings and expert opinion on a particular matter and which is financed from the state budget, does not in itself justify the fear that these experts will not be able to act independently and impartially.<sup>39</sup> So, experts need to carefully examine all relevant points and explain in detail their conclusions and the courts must carefully review, critically consider and properly evaluate these conclusions. Although the experts do not judge, judges have been "sentenced to expert witness" in their work, since in the majority of civil and criminal cases only with their expert assistance can qualitatively determine the factual situation.

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<sup>36</sup> More about the conditions, the determination of and the exemption of the expert see Čizmić, p. 677-706. i Roksandić Vidlička, p. 401-425.

<sup>37</sup> See footnote <sup>30</sup>.

<sup>38</sup> See *Vasileva v. Bulgaria*, §§ 74., appl. no. 23796/10, judgment. 17.3. 2016., Final 12/09/2016.

<sup>39</sup> See *Letinčić v. Croatia*, appl. no. 7183/11, 3.5.2016. , §§ 62.: „With regard to the question of neutrality of the experts who produced the Centre's report, the Court notes that it is understandable that doubts could have arisen in the mind of the applicant as to their impartiality given that they were employed in the Centre, which was designated by the Ministry, his opponent in the administrative proceedings at issue, to provide the expert reports on the subject matter of the dispute. However, while the applicant's apprehensions concerning the impartiality of the experts may be of a certain importance, they cannot be considered decisive as there is nothing objectively justifying a fear that the Centre's experts lacked neutrality in their professional judgment. In the Court's opinion the very fact that an expert is employed in a public medical institution, specially designated to provide expert reports on a particular issue and financed from the State budget, as is the case with the Centre, does not in itself justify the fear that the experts employed in such institutions will be unable to act neutrally and impartially in providing their expert opinions.“

Of that, ultimately depends outcome of the case or whether someone will be found guilty or not for committing the criminal offense or whether to compensate damage to injured party. It is questionable whether the court may otherwise determine the facts from those indicated by the expert in his report or whether the court is tied by the finding and opinion of experts. In the theory of procedural law, it is generally accepted that the court must undertake its assessment of the expert's report, as well as any other evidence. However, it is indeed questionable can the court critically evaluate the expert's finding and opinion when the court does not have necessary professional knowledge which is why he called the expert.<sup>40</sup> Although the role of expert in the evidentiary proceedings is undoubtedly very important and precious for the court and the parties, ultimately an assessment of findings and opinions is brought by the body which appointed an expert. Specifically, this means that the expert (indirectly) does not make a judgment, but his expert knowledge, which the court does not have, helps to establish all relevant facts in some case. Therefore, an expert should assist the court solely in determining the facts and never when deciding on the application of the legal norm. The court cannot seek answers to legal questions from the expert and the expert cannot indulge in the legal issues and cannot base its opinion on the interpretation of legal regulations. In other words, the expert cannot speak about the degree and the percentage of guilt but only about the omissions of participants in treatments which have a causal link with the deterioration of health while the conclusion on the contribution to the emergence of harmful consequences is brought by the court according to a free assessment.<sup>41</sup> In relation to the claim for compensation damage caused by medical errors, the doctor-expert will clarify the medical condition to the court, determine whether or not there is a causal relationship between medical treatment and incurred damage, whether the physician's procedure was in accordance with the applicable medical standards. The doctor-expert will determine, if there is any causality, what harmful consequences the patient will suffer or whether the damage will occur even if the doctor's treatment was in accordance with the medical standard, determine the overall health of the injured party and, if so requested, determine whether the patient has contributed to the occurrence of his or her own damage by his or her behavior (by making or failing to comply with the doctor's instructions).<sup>42</sup> In the case of *Jurica v. Croatia* the applicant's assertions that the experts were not impartial were very broad and general and did not contain an objectively justified allegation that would cast doubt on their independence or impartiality.<sup>43</sup>

### 3. CONCLUSION

Findings and opinions of medical experts are the most important evidence in all court proceedings for medical malpractice or medical error. Without this finding and opinion, it is not possible to ascertain the causality between the act/omission and the fault of the health worker. It is therefore of crucial importance for the exercise of citizens' right to a fair trial in addition to the normative and realistic assurance of right to access to court through criminal and civil proceedings, insure independent and impartial expertise. Concerning the objectivity of findings and opinions of medical experts, the ECHR has already discussed in a series of decisions in which he has set out certain standards for the legislation and the judiciary of the Member States. The findings and opinion of medical experts, as well as all other evidence and according to the rule of free assessment of evidence, must be assessed by the court, not only in terms of formal requirements but also of content. In order to reduce the possibility of non-objective findings and opinion of experts and for the complete and proper determination of the

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<sup>40</sup> Therefore, opinions are that due to the lack of sufficient medical education on the cases' problem areas, it is highly unlikely that in practice court impartiality on the expert's opinion exists. Raspović, p. 165.

<sup>41</sup> Čizmić, p. 475.

<sup>42</sup> So Raspović, p. 168.

<sup>43</sup> No violation of Article 8 - Right to respect for private and family life (Article 8-1 - Respect for private life) See *Jurica v. Croatia*, §§ 93.-96.



factual situation in any court proceeding (criminal and civil) it is necessary to set some preconditions as standards of correctness of the findings and expert opinion. Therefore, the ECHR emphasizes that due to the lack of professional medical knowledge by the court itself, the finding and opinion of the medical practitioner has a decisive influence on the assessment of the facts and is considered to be an essential part of the evidentiary procedure. Deficiency of neutrality by a court expert in certain circumstances may lead to a violation of the principle of equality of the parties and it is also necessary to remove the slightest doubt that the experts have carried out their work independently and impartially i.e. objectively. For this reason, the court must prevent the experts from reaching a verdict, since it is a role which, according to the law, does not belong to them. Thus, a case in which a medical expert who was not neutral actually adjudicated is a violation of a party's right to a fair trial.

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## OPACITY AND SILENCE SURROUNDING THE CULTURAL PROPERTIES TRADE

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### **ABSTRACT**

*The intensification of the illicit trade and the growing number of disputes about the return of smuggled or illicitly exported cultural properties represents an alarming signal that shows serious questions on the real capacity of the restrictive laws to fulfill protective purposes. First of all, the question should be dealt with by the countries rich in cultural patrimony, which should carry out a role of “cultural avant-garde” and prepare new forms of struggle against the illicit traffic of cultural properties. The means, that can be used to reach this aim, can be various and require a change in the perspective compared to the traditional national policies in the field of the cultural property. In many cases it is a matter of solutions easily to be solved, which even if they require an organizational effort, they might not be a burden on the public finance. It is to be considered, for example, the opening of an international market of works of art, where States can give the works of art that are not essential to the national history, starting from the less important archeological finds and/or from the foundation of a compulsory state system of registration of high valued artefacts and their transactions. This market should involve not only the public bodies but also the private ones. In the first case, resources are removed from the black market and the illicit purchase becomes less convenient, since it exposes to the risk of obtaining not authentic materials and being involved into judicial inquiries. The decline in the demand would have a direct effect on the safeguard of archeological sites, while avoiding the non authorized excavation in new areas and the loss of scientific information. The revenues deriving from the archeological resources might be used to finance research projects, safeguard and promotion or to support a state system of cultural heritage registration. The certification of the cultural, public and private, property, should offer to the buyers the possibility of checking the legitimacy of the title before of carrying the transaction out, by rebuilding the good faith not on the base of criteria which are probable to suppose but through documentary certainties. The birth of national or international systems of cultural property registration offers a precious occasion to stabilize and implement the art market, while clarifying the grey zone made up of “opacity and silence” that often surrounds the trade of works of art.*

**Keywords:** *archeological goods, cultural heritage, illicit trade, protectionist laws, treasure.*

### **1. INTRODUCTION**

In most of the judicial systems in the world the public or private cultural properties are submitted to a «special judicial system which is different from the general judicial system of the property and from the one of the goods belonging to the same genre». It regards some restrictive measures adopted with the aim of protecting the «national treasures possessing artistic, historic or archeological value», by avoiding the dispersion and guaranteeing the public use. These limits really change in parallel to the type and the wealth of goods which are present in each country. The protectionist measures provide for safeguard mechanisms which run from the ban on exporting to forms of customs check with the issue of special authorization, or from the prohibition on the alienation to the introduction of a pre-emption right in favour of the state. One of the strictest forms of protection refers to the archeological goods which, as you know, in some countries like Italy, belong to the state ex lege when found. This type of legislation wants to safeguard the area where the discovery is made for the scientific information it can

give to the experts. In this field, the action of the European Council has been particularly relevant since the 60s with the approval of the London Convention, which drew the attention of the international community to the necessity of giving to the “archeological excavations their full scientific meaning”. The article 1 of the European Convention stipulated in Malta 1992 expressly refers to the “setting of the finding” as an integral part of the archeological heritage, by indicating among the aims the protection of the cultural sites as “source of the European collective memory and instrument of historic and scientific study”. In addition to this, the convention asks the states to adopt policies of planning, which are able “to totally take into account the archeological sites and their setting” so that “the necessities of the archeology and the development of the territory coexist”.

## **2. THE RECOVERY OF THE TREASURE**

The interest in the protection of the immaterial assets of knowledge, that can be spread from a historic site, has marked the policy of the cultural property for the last years, by influencing even the choices of those countries which have liberal rule on the circulation of cultural objects, such as England which reformed the Crown prerogative on found treasures. The evolution of the English rule shows the becoming aware, that joins most of the modern legislations, in reference to the opportunity to protect the cultural properties, not only for their economic value, but above all for the cultural and scientific meaning they have. In Italy, the binomial defense of the historical heritage and preservation of the memory has by now a secular tradition which has its roots in the measures of the pre-unitarian states. These states established some principles which the following European legislations were inspired by, such as the control on archeological sites with a reservation on the extraction of material in favour of the state. This kind of measures doesn't distinguish between public and private properties, they postulate not only a dispensation to the rules of the Roman Law about the recovery of the treasure, but also an evident compression of the property law in name of public interests, connected to the preservation of the memory and to the use of the cultural heritage for educational purposes in the oldest provisions. In Italy, as elsewhere, only in the following years the activity of archeological research has been founded on the need that “it exists a unitary evaluation of the research criteria in a given place and at a given moment”. This aim hasn't always been achieved by suitable regulatory instruments. In particular, the “nationalization” of the goods kept in the subsoil didn't slow down the request of cultural properties, but in some way, it made them more attractive from a collector's point of view. The idea that the archeological assets, regardless of their economic or historic value, belong to the state is legitimate. However, it doesn't leave any space for the selling of older materials, by addressing the request towards illicit channels, such as clandestine excavation. In this context the only penal repression isn't enough to safeguard the places of the discovery, whereas the option to leave the goods that don't appear significant to the owner of the ground and to the discoverer could fulfill a contrast function to the archeological crime by increasing the creation of a licit market, similarly to England. It is a matter of operating an important change in the perspective for the source countries, restoring rules which are often very outstanding, like in the Italian case. The reserve of the archeological finds discovered in the subsoil in favour of the state has been introduced in Italy since 1909 (so called Legge Rosadi) regardless of the circumstances of the finding, of the person who makes the discovery, the quality and the value of the artifact. In reference to the goods of “historic, archeological and paleontologist interest”, it is made a stated derogation from the rules of the “treasure” considered by the Civil Code. Compliant with the Italian archeological goods, the only remaining way of buying the property by a private is the evidence of the ownership already in the age previous to the approval of the Rosadi Law or the acquisition in the free market within the limits where it is possible. In fact, the Italian rule provides that the private archeological goods (as any work of art that has been made for more than fifty years)

cannot be freely sold, because it exists a pre-emption right by the state, which can buy forcedly in case of exportation. Within these schemes, few space is left to the private's decision making autonomy, whereas in the other systems, even of protectionist matrix, it is present a major safeguard of the cases of ownership in the rules regarding the archeological finds. The French case is emblematic. The interest in maintaining the French cultural assets has found the cornerstone of the public politics, which is aimed at promoting the discovery and the preservation of the finds kept in the subsoil, in the institution of the “precautionary archeology”. The approval of the Loi no 2001-44 17th January 2001 made possible to impose on the public and private soils firstly diagnostic activities and later excavations where works potentially able to damage elements belonging to the archeological property must be executed. The materials which were found during the procedures of the “precautionary archeologies” until the entering in force of the law on «liberté de création, l'architecture et le patri moine» were divided in “parts égales” between the state and the owner of the land. On the other hand, the fortuitous finds became purchases under the availability of the owner of “du fonds” and of the discoverer, except for the faculty of the state to act in claim by paying an “indemnité” normally in proportion to the value of the good. For a long time this system has left a wide space of feasibility the privates, who had the possibility to become assignee of a part of the found property. This system, changed by the law promulgated on 7th July 2016 has left for a long time a space of action to the privates because they became owners of a part of a recovered heritage, they were involved in the classification procedures and received a compensatory indemnity for the limits resting on movable property qualified as historical monuments. The guarantee prepared for the privates are also extended to the fortuitous finds, which are acquired by the owner of the soil and of the discoverer, unless the faculty of the state to lay claim in change of an indemnity normally in proportion to the value of the good. The evaluation of the find shall be adequate even in the case of exportation. The French system represents under many aspects a possible example for countries, like Italy, which have formed their own rules on very rigid schemes. The Loi 2016-925 actually simplified the system and reinforced the public prerogatives on the archeological finds, moving the French legislation close to the Italian and Spanish ones. Particularly, as far as the “mobiliers” goods are concerned, it is set forth the unenforceability of the articles 552 and 716 of the code civil both in presence of discoveries made after “operation archeologique” and under the hypothesis of fortuitous finds, provided that the finds were discovered on lands which had been acquired after the law entered in force. In the first case the new system introduced a presumption of belonging to the state from the moment of the discovery, in the second case from the moment when a scientific interest is found to the preservation of what was fortuitously found. Even the archeological goods, which were discovered on the lands acquired before the law 2016-925 came into effect, were put under restrictions. In fact, they were given to the custody of the states offices for the time necessary to the scientific study of them, which cannot however be longer the five years. The private owner or discoverer must exercise his/her rights on the found objects under a specific administrative procedure, whose infringement causes the loss of the property of the archeological goods and their free conveyance to the state. Furthermore, the discussed goods can be object of specific prescriptions directed to guarantee the preservation and the accessibility from the state services.

### 3. THE ENGLISH LEGISLATION

The approval of the Loi 2016-925, in attributing to the state the ownership of the archeological goods, actually increased the normative homogeneity existing in Europe, by underlining the singularity which characterises the British law where the regulations on the safeguard of the archeological goods are very little restrictive, in line with the liberal approach which characterizes the circulation of historic – artistic interest movable goods in England.

The distinction between the “Ancient Monuments”, “Historic Buildings” and “cultural objects” represents the supporting axis around which the modern legislation is developed. This attributes forms of cataloguing only to the first two types of goods; the two categories of cataloguing are known as “Scheduled Monuments” and “Listed Building”. The prescriptive regulations are, instead, very little limited in reference to the cultural objects of private ownership and the scarcity of restrictions involves also the archeological finds. In fact the owner of a land can undertake, without any authorization, campaigns of excavations and keep the found objects, provided that they do not belong to the category which can be classified as treasure. Those ones who wants to use the metal detector shall have a «written consent», according to which is disposed by section 42 of the Ancient Monuments and Archaeological Areas Act del 1979, only in some places considered of relevant interest such as: «the site of a scheduled ancient monument or of any monument under the ownership or guardianship of the Secretary of State or a local authority by virtue of this Act; or (b) situated in an area of archaeological importance». In these cases the planning of the works must involve the governmental bodies known as Historic England and Cadw , which have jurisdiction respectively for England and Wales. Beyond the «protected places» the person who discovers a find can communicate it to the “Finds Liaison Officers” (FLOs ) who work in an organizational body known as “Portable Antiquities Scheme” (PAS), coordinated by the Department of Britain, Europe and Prehistory del British Museum. The FLOs have the task to give information about the found object and to make the people aware of the value of the historic finds, by encouraging the citizens to make their discoveries available through the cataloguing in a specific database. This system, although merely voluntary, produced significant results with the analytical indexing of millions of artefacts and the identification of unknown sites, which in many cases allowed the archeologists to re-examine the framework of the existent knowledge on the English history. In 2015 only, for example, 82.272 finds were discovered and registered and were found precious evidences of the past as a Roman villa in the south-west Wiltshire. The information contained in the database are available to the users in a different way regarding the accessibility level which is granted by one’s own account. On more than 8000 registered contacts about a thousand can take a look of the overall dates of the PAS, which appear to be of fundamental importance for the academic researches and the excavation campaign. The success of the “Portable Antiquities Scheme” is essentially connected to the support towards the metal detectorists, who are assembled in associations and collaborate with the Finds Liaison Officers. They benefit of the approval by the governmental authorities since they contribute, as it is underlined in paragraph 27 of the Code of Practice, to the «discovering» of «many objects of great importance for the nation’s heritage». However, the English authorities seem to underestimate the possible risks connected to the excavations made by non qualified persons. In the system, in fact, there are not forcible rules which impose a compulsory training for the metal detectorists and/or the release of special authorization to proceed with the excavation of archeological objects. The absence of these provisions seems to weak the efficiency of the British protective system, which deserves to be brought to the attention for its attempt to do a compromise between ownership rights and the public use of the historic property.

#### 4. CONCLUSION

The regulation of the archeological goods in England, even with the underlined critical remarks, can represent a model for those countries which excessively hardened protectionist measures, by “nationalizing” the goods which are kept in the subsoil. In the field of archeological finds, the rigidity of the regulations isn’t actually directly proportional to the achievement of results, that are satisfactory from a point of view of the protection, as the permanent illicit traffic in works of art from Italy shows. The problematic in explaining the meaning of good faith that is valid in an international environment and the recourse to the “forum shopping” in order to form,

even for stolen or illegally exported objects, title deeds autonomous from the national law of the country of origin, are additional obstacles to the protection of the historic heritage. Then, the circulation of the antiquities illegally excavated represents a vulnus for the legal market, by exposing the workers in the sector, but also the individual collectors, to the risk of buying stolen or illegally exported objects. Therefore it is put the question if the current legal restrictions are indeed able to carry out protective aims. This question should firstly be dealt with by the countries rich in cultural sites, which can have a role of “cultural avantgarde” by experimenting new forms of fight against the illicit traffic. The means which can be used in order to get this aim are various and require a radical change of perspective with respect to the traditional policies in reference to the cultural heritage. It is a matter of solutions that even if requiring an organizational effort, they may not be a burden on the public finance. Let’s think about, for example, the opening of an international art market which the states can give the goods that don’t seem essential for their national history, starting from the archeological finds of less importance or from confiscated goods of anonymous origin. In the Italian case, the storage spaces of Archeological Offices might be voided, where millions of finds have been for about hundreds years of excavation under state control. Some of these aren’t worth much, either from a scientific or economic aspect. Nevertheless, the ministry has made different attempts, till now an estimation about the numbers of the owned finds and their value doesn’t exist. Most of the finds stored, when examined, are kept forever in the storage spaces, since they aren’t relevant apart the documentary research. Therefore, it has a logic that the state is involved in order to put all cultural heritage under safeguard and establish, ex lege, as in France some effective restrictions so that the study of the materials is allowed, but in my opinion isn’t reasonable to remove the finds of less value from the circulation on the market. The international art market run by the state may be a possible compromise to create a licit channel for the sale, which is intended to remove resources from the undeclared market, by making less convenient the illegal purchase. The fall in the demand would have a direct effect on the safeguard of the archeological sites, by avoiding the illegal excavation in new areas and the lost of important scientific information. The money deriving from the sale of the archeological objects could be used to support projects of scientific research, for the safeguard and promotion of the historic heritage or to support a state system of registration of the cultural heritage. This registration may be another mean to fight the illicit traffic. Under this profile, it would be appropriate to create a compulsory state system of registration of the most important works and their transactions, that involves not only the public bodies but also the private ones. It should be set that all the artifacts, whose value exceeds a given threshold, must be registered. I’m thinking about a public register of the cultural heritage based on the Italian model of other movable property such as the cars and the ships. The ownership of the goods in the public register is a proof of the ownership of the property rights. It is also possible to imagine an open access online platform where the data related to the owned object can be put. When an entry test is satisfied, a certificate with an object identification numeric code is attributed. The entry test is positive when it considers, for example, the description of the artifact, the date and the place of purchase, the possible title of provenience or the elements in support of the legitimacy of one’s ownership. Through this system, it couldn’t anymore be possible to sell works of art, if a certificate of property is not present. In this way, each buyer would have the possibility to control the legitimacy of the title before doing the transaction, recreating in possible judicial occasions his good faith not on the basis of supposed criteria but by documentary proofs. The registry office of the private and public cultural property represents a relevant occasion for making the market of art stable and implementing it through the clarification of the grey area made by “opacity and silence”, that often surrounds the sale of works of art.

Under this profile, the birth of national and international systems of cultural property registration is suitable also to improve the contemporary art market, which is invaded by fakes and is sometimes managed by not very credible Archives.

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## PERSONAL REQUIREMENTS FOR SUPERVISORY BOARD MEMBERS AND CONFLICT OF INTERESTS

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### ABSTRACT

*Question of current and future (potential) conflicts of interests is of great practical importance for the work of the already established Supervisory Board in the company. The reason for this lays not only in the fact that neutrality of the conflicting Supervisory Board member is endangered, but also in the other disadvantages to the normal functioning of the Supervisory Board in general. Spectacular lawsuits involving large companies have increasingly focused public attention in Europe on the functioning and functional deficits of the supervisory bodies. Solely due to the "stricter duties of care and action" discussed in the wake of this, the standards that are applied to a responsible supervisory board activity have increased significantly. The Croatian Companies Act has regulated the post of member of the Supervisory Board as a secondary function and therefore assumes that the member of the Supervisory Board still has one main occupation (as a member of the Management Board of another company, member of a law firm etc.) or holds supervisory board mandate in the other Corporation. However, dual board mandates have considerable potential for conflict because the dual mandate holder is basically committed to the interests of two companies (servant of two masters). This loyalty conflict is particularly acute in the group of Companies. Dual board mandates holder always has to consider the interests of both "masters": while acting in the board of the parent company he must consider only their interests and in the board of the daughter-company exclusively their interests. Because of this separation of obligations, he can't rely on the fact that a breach of the obligations of an organ in one area is justified in order to comply with the duties of the other organ. Furthermore, the norm in provision Art. 261 of Croatian Companies Act states that a member of the supervisory board cannot at the same time be a member of the executive board, authorized signatory or authorized representative of the company for the entire business. That norm provides for the possibility that the supervisory board appoints individual members of the executive board for a limited period of time to substitute missing or prevented members of the management board. These provisions are defined as the expression and the effectuation of the dualistic system and of the rule of separation of functions between the Management Board and the Supervisory Board. The provision deals with the fact that the executive and supervisory bodies are separated as such, but that the functions of both organs are actually carried out by the same persons, and therefore unbiased and effective supervision of the management is no longer guaranteed. This paper will cover those issues and provide for possible legal solutions.*

**Keywords:** *Company law, Supervisory Board, Management Board, Dual board mandates, Conflict of interests*

### 1. INTRODUCTION

When it comes to the disposal of capital assets, the corporate governance system separates the ownership of shares and business interests from the functions and responsibilities of operational management of the company's business. Although business and management decisions are always made by specific people, they don't made them as private persons but as members of

the organs of the capital company. The decisions are made in business and legal transactions with third parties. The subject of these relations is always the Company as a legal person. All natural persons who have the power to represent it, do so on behalf of the company and at their own risk. Thus, unlike closed family businesses and limited liability companies, where there is a recognizable personal union of membership and business management functions, all joint stock companies must have supervisory boards. The basic role of the supervisory board in a two-way corporate governance system is to represent the company in relation to Management and to carry out the supervision of the company's business, with the power to make binding decisions about the pursuit of business policy goals. Norm in Art. 263. Croatian Companies Act (further in text: CCA) regulates the mandatory scope of duties of the Supervisory Board. Yet, not all the rights and obligations of the Supervisory Board are listed in this provision. The provision provides the legal basis for the essential task of the Supervisory Board - the monitoring of the Management Board. Besides, it delimits the competence of the Supervisory Board vis-à-vis the Management Board and also towards the General Assembly. Other essential competencies of the Supervisory Board are the appointment and dismissal of members of the Executive Board; conclusion and termination of employment contracts with members of the Management Board; determining the remuneration of members of the Management Board; adoption of rules of procedure for the Management Board; consent to competitive activities of members of the Management; granting of credit to members of the Management; representation of the company vis-à-vis Management board members; acceptance and request of Management Board reports; Participation in the Annual General Assembly; submission of a declaration of conformity to a listed company; audit of the annual financial statements, management report and resolution on the appropriation of profits; participation in the registration of the capital increase; participation in the determination of the conditions for the issuing of shares in the case of authorized capital; participation in filing for a capital reduction; contest authority against resolutions of the Annual General Meeting to name just a few (Hambloch-Gesinn/Gesinn, p. 1004). Norm in Art. 263 CCA emphasizes in ss. 1 the supervisory task of the supervisory board in order to immediately assign extensive inspection and audit rights to the supervisory board (ss. 2 and 3) and to assign the audit mandate for the annual and consolidated financial statements. According to ss. 4, the duties of the Supervisory Board also include convening a general meeting if the company's welfare requires it. Norm in ss. 5 regulates the competences of the Supervisory Board in questions of the management. Such duties can't be entrusted to the Supervisory board member while he holds the other mandate in the management of the company. Supervisory Board has influence on the management of the company through its power of approval reservations. Although they do not affect the right of initiative of the Management Board as a management body, they do however tie important management actions to the approval of the Supervisory Board, thereby enabling it to take preventive measures. Yet, approval refused by the Supervisory Board may be replaced by a resolution of the General Meeting. Finally, norm in ss. 5. prescribes personal liability of members of the Supervisory Board (Habersack, p. 1293).

## **2. COMPETENCIES OF THE SUPERVISORY BOARD IN DETAIL**

The primary duty of the Executive Board is monitoring of the company management, so not every single measure of the board has to be controlled. In addition to the management decisions, the management measures to be supervised also include significant individual measures, in other words all acts of management important for the business and development of the company. If management decisions and essential individual measures are not taken by the Executive Board itself but are delegated to subordinate management levels, the activities of these decision makers must also be closely monitored (Roth, p. 346). The general monitoring task, like most of the legal tasks of the Supervisory Board, is directed to the Board as an

institution and as such can not be transferred to committees. However, individual areas of responsibility can and should be transferred to committees or individual members. Such a delegation leads to an increased responsibility of the individual (committee) members; the other members in these cases, yet, have a residual responsibility and thus the obligation to control their activities, especially if there is evidence of inadequate performance of the duties. Every member has to contribute to the fulfillment of the plenary tasks and to ensure, within the scope of his/her possibilities and rights, the proper fulfillment of those tasks. For the requirements of the work assignment, the secondary nature of the mandate must be considered. Yet, each member must ensure that they are qualified to perform the tasks even though this is not their only job. Essential statement of the norm is the separation between management and supervision tasks. Supervisory Board has no executive power whatsoever. The Board has to supervise the management, ie to ensure that the Management Board does everything necessary to increase the assets of the company and to avert any damage away from the company. The Management Board must recognize developments that endanger the company in good time and take countermeasures. In order to monitor Management Board, the Supervisory Board has the option of requesting reports pursuant and also has its own audit rights. The Board must also ensure that the Management introduces and utilizes a suitable early warning and monitoring system (Hambloch-Gesinn/Gesinn, p. 1005). At the same time, the Supervisory Board must ensure that every member of management complies with its executive function. Immediate contact with executives is permitted and may even be required in individual cases. The above-mentioned management measures are not only to be monitored on a case-by-case basis, but can also be monitored continuously. On the other hand Supervisory Board holds its meetings annually or when situation requires so. There is no duty on the part of the Supervisory Board to introduce a risk management system, but an obligation can be derived to monitor such a system introduced in the company. Density of control enforced by Supervisory Board depends on the net assets, financial position and results of operations of the company. Crisis signals lead to increased monitoring intensity. The right to inspection extends to the entire dataset of the company, including digitized reports. Data of affiliated companies and other third parties can also be a part of the control, even if the Management Board has the corresponding access rights. Functionally, the right of inspection is limited by the task of supervising the management of the company, ie the supervisory board must not be allowed to act as the legal auditor of the management board. But it does correspond to its monitoring task, when it randomly examines individual management measures, even at the risk of a certain burden on the cooperation with the Management Board. Additional information may be obtained by the Supervisory Board through questioning the Management Board and company employees. Concern about a breach of confidentiality by individual members of the Supervisory Board does not give any secrecy rights to the management (Ulmer, p. 155). Nevertheless, the future-oriented legal advice given to the management shouldn't be completely separated from a past-oriented monitoring, because the control also implies the examination of future-oriented measures. Accordingly, it is widely recognized that the Supervisory Board can also advise the Management Board in the context of supervision. Surveillance consulting only refers to the main management measures and not to the ongoing operational business. Through the advice, any errors can be detected early so that corrections can be made. Conversely, it would also be just as wrong to qualify the Supervisory Board as an "entrepreneurial body". For even though the Stock Corporation Act has increasingly emphasized the forward-looking, advisory role of the Supervisory Board over the course of time, this is merely a functional aspect of the supervisory activity, not an additional executive competence (Henze, p. 3309).

### **3. PERSONAL REQUIREMENTS FOR THE SUPERVISORY BOARD MEMBERSHIP**

The Supervisory Board must have at least three members. The Statute may stipulate that the Supervisory Board has several members, but their number must be odd. However, the highest number of members that a supervisory board may have may be determined, depending on the company's share capital (9, 15 or 21 members). A member of the supervisory board can be any business capable person. This can be a foreign citizen, and it is allowed that all members of the supervisory board are actually foreign citizens. A member of the Supervisory Board may not be a person who has been punished for certain criminal offenses (misuse of bankruptcy, creditors' favoritism or breach of business book-keeping obligations) for a period of five years after the verdict is pronounced, (Art. 255. CCA in conjunction with Art. 239. CCA). Furthermore, the person against whom the security measure is pronounced and is prohibited from performing the occupation covered by the subject of business may not be the member of the Supervisory Board. A member of the Supervisory Board may not be a person who is already a member of ten supervisory or administrative boards; Prokurist of the company; Agent; member of the board of directors; deputy member of the management or executive director of a daughter company. According to the Act on the Prevention of Conflict of Interest, state officials may not be members of the supervisory boards of companies (Petrović, p. 123-124). Only a natural person can be a member of the Supervisory Board. This requirement applies without exception, thus to shareholder representatives as well as employee representatives and other members. Legal persons, commercial companies, associations, foundations, institutions, authorities and bodies of any kind are excluded from a supervisory board mandate. Every member of the Supervisory Board, whether shareholder representative, employee representative or other member, must have unlimited legal capacity. It must therefore be of age and must not be permanently in a state of pathological mental disorder. Persons with limited legal capacity may not become members of the Supervisory Board with the consent of the legal representative nor on the basis of the authorizations (Habersack, p. 945). Due to the increasingly complex accounting and auditing regulations, it makes sense that the Supervisory Board also has at least one proven financial expert. This was initially recommended only for "capital market oriented" corporations but is now widely used in all types of companies because it ensures a generally high level of independence of Supervisory Board that consists of experts. Anyone who is already a supervisory board member in ten commercial companies may not take on another mandate with a stock corporation, regardless of the possible legal justification (election, substitution of missing member, court order). However, the decisive factor for this is not the time of the election, but the time of the inauguration. The purpose of the regulation is, on the one hand, to prevent the concentration of (supervisory) power in the hands of a few and, on the other hand, to ensure that the Supervisory Board member has enough time for performance of his tasks. Member of the Supervisory Board may not be a person who is the legal representative of a dependent company. Also for this legal exclusion reason, it depends not on the conditions at the time of the election, but on the conditions at the beginning of the term of office. The prohibition of interlocking relationship is based on the fear that the monitoring of the management board by the supervisory board member fails less intense, if that member is in such dual mandate position. The prohibition also applies if the supervisory board of the other corporation is not prescribed by law but has been voluntarily formed. In the case of a foreign corporation, the prohibition on its legal representative or, in the case of a monistic constitution, on the executive directors, applies if a member of the management board acts as a member of supervisory board or non executive director of the foreign company (Hoffmann-Becking, p. 589). At least, non-executive directors can remain eligible if they have transferred their power of representation completely to the managing directors, excluding their own. Similarly, executives of the dependent company should not be included and therefore appointed as members of the supervisory board in the ruling company.

#### 4. CONFLICT OF INTERESTS

The independence of the members of the Supervisory Board should promote the quality of their decisions. It is designed to help ensure that decisions are based solely on the interests of the company and that they are not misled by binding to divergent interests, be it internal to the company through a commitment to the interests of the board, or external to others through stakeholder engagement. The law does not require that all or even the majority of Supervisory Board members should be independent. Current and potential conflicts of interest are of great practical importance for the work of the already established Supervisory Board not only because of the endangered neutrality of the conflicting Supervisory Board member, but also because of the disadvantages for the functioning of the Supervisory Board in general. Conflicts of interests may also play a role in the election of the Supervisory Board (for example when the Supervisory Board candidate is (i) a confidant of the majority shareholder, (ii) an executive body member or (iii) advisor to a major client or competitor of the company). The CCA largely accepts conflicts of interest of members of the Supervisory Board, in particular in group situations and with regard to employee participation. Therefore, for example, the activity for a rival company or the simultaneous consultation of the majority shareholder is not a fundamental impediment to the proper fulfillment of duties of a Supervisory Board member. Such potential conflict situations are to be resolved in the ongoing work of the Supervisory Board, eg by disclosure, voting ban or exclusion from meetings. Members are also subject to organizational loyalty by virtue of their appointment. However, concretisation may not be carried out under a simple takeover of the principles that apply to members of the Management Board. Rather, it must be taken into account that activity in the Supervisory Board is a typical side job. Therefore, it is not required that members unconditionally give precedence to the interests of the company. However, own business relationships with the company must be held in the borders of acceptable behavior. Anyone who over-benefits by exploiting information obtained from his official duties is always in a breach of trust. If no other solution is found the member should give up on one of the conflicting offices. The loyalty obligation of the Supervisory Board member requires the Supervisory Board member to recognize the collisions of interests and to act accordingly. Member of the Supervisory Board must give priority to the interests of his company as part of his organ activities. Even in the case of legally established conflicts of interest, for example when belonging to an organ of another company, the fulfillment of duty to one party can't justify a breach of duty towards the other. Therefore, if necessary, the Supervisory Board member must at least abstain from voting in the case of corresponding resolutions or resign from his mandate in the event of insolvable conflicts of interest. A temporary cessation of the mandate due to public prosecutor's investigations against the member in the private sector is ruled out due to the overall responsibility of each individual member of the Supervisory Board for the performance of the duties of the entire body. If the Supervisory Board member does not voluntarily comply with this obligation, the remainder of the Supervisory Board is required to file an application for dismissal with the court. The same applies to Supervisory Board members elected by certain groups and, in addition, also to seconded Supervisory Board members, as they have the same duties as elected members of the Supervisory Board. In particular, the delegated member of the Supervisory Board may only pursue the interests of the authorized representative to the extent that they are not in conflict with the interests of the company. In order to avoid possible conflicts of interest, it is also inadmissible to seek advice from individual members of the Supervisory Board without a corresponding resolution by the Board in the area of its activity, irrespective of whether or not the member is a professional. Because there is a risk that the Supervisory Board member will hardly vote against his own advice. Although advice should be part of the monitoring task, it must not be forgotten that the limits to participation in management and the separation of powers between the organs can easily be exceeded.

If, however, such advice is considered admissible following a resolution by the Supervisory Board, the Supervisory Board member may not claim any separate remuneration, since this is the part of monitoring activity. However, outside the Board, every member is free to conclude consulting contracts with the management. Members of the Supervisory Board are already subject to a loyalty duty. The Supervisory Board member may not exploit his office or the associated influence in order to disadvantage the company in favor of its own interests or the interests of third parties. If necessary, the member must abstain in addition to the disclosure of the conflict or as ultima ratio resign from his mandate (Möllers, p. 1619). However, since the Supervisory Board activity is a secondary activity, a distinction must be made as to whether the person concerned is acting as a member of the Supervisory Board or if he is acting outside this activity: only in the first case the company interest has a priority. Workers' representatives are also required to align their organ activities with the interests of the company alone, so they are not allowed to participate in a strike against the company. Purpose of the company is to achieve profit. Other interests may only be taken into account as ancillary conditions insofar as they are within the scope of the margin which inevitably results in the entrepreneurial specification of the profit as a main goal. Apart from their organizational tasks, members may give priority to their own interests (eg as an entrepreneur, employee or board member of another company). Nevertheless, there is also a weakened duty to take account of the interests of the company within the bounds of what is reasonable; In particular, it is unlawful for a member to exploit business opportunities to which it has gained access on account of activity for the company. However, the member is not obliged to actively promote the interests of the company against his own interests. Conflicts of interest (such as the activity of a rival company) must in any case be disclosed to the plenary session and may oblige the member to abstain from voting. In specially serious circumstances he should resign from the position (Grigoleit/Tomasic, p. 827-828). The Supervisory Board also has a right to a free business judgment. This special right may arise in situations such as in the case of unlawful or particularly risky executive board action. If the documents submitted to the Supervisory Board are incomplete, implausible or doubtful, the Supervisory Board must conduct its own investigations which should include clarification of the questions regarding the intended purpose of the legal transaction, the use and suitability of the means, opportunities and risks and alternative courses of action. If necessary, this further investigation should be undertaken with the involvement of experts (Hambloch-Gesinn/Gesinn, p. 1075). Entrepreneurial decisions are driven by forecasts and not as a result of their future orientation. Even without a future-oriented forecasting element, it can be an entrepreneurial decision; the decisive factor is that there is a legally non-binding, ie discretionary decision between several options for action. Decisions of the Supervisory Board regarding the selection of Executive Board members and the determination of their remuneration are also entrepreneurial decisions. The deterrent effect of the Business Judgment Rule presupposes that the members of the Supervisory Board are "reasonably" informed, ie without negligence, namely that they are adequately informed. As a result, they may need to actively seek information if the information provided by the management is clearly insufficient. However, they are not obliged to exhaust all available sources of information, because this is simply not a realistic option. The "basis of adequate information" required by the law for the decision, in turn, requires a decision on the costs and benefits of further information, for example the costs of an expert opinion. However, the question of adequacy is again fully subject to judicial control. Nevertheless, a certain degree of discretion should also be exercised when assessing the necessary information basis, since a complete information basis is not required by the law. Depending on the significance of the decision, a broader information base will therefore be legally required. When it comes to business decisions of the supervisory board, it is all about giving consent to the actions or omissions of the management of the company. It is important task of the Supervisory Board to properly inform them of what they have to decide and to

remind them that they should act in the interests of the company. Lack of due care would be obvious, for example, if the Board gives consent to the merger after only ten minutes of deliberation. It can be said that when a business judgment exceeds the boundaries of responsible corporate management, for example, when the loan is approved to person on the verge of bankruptcy, then there is a breach of duty. As mentioned earlier, the conflict of interests is solved by refraining from voting. If a member of the board does not act in this way, his action is unlawful. He should clearly make known that he disagrees and vote against the adoption of such a decision, not only refrain from voting, and do everything to convince the other members of the Supervisory Board to do the same (Barbić, p. 919). For an action outside the sphere of the company and therefore for an act outside the supervisory board office, an unconditional priority of the company interest is not to be recognized. However, they shouldn't actively violate the interests of the company by, for example, inducing the management board, the supervisory board or a senior executive to conduct such legal acts or measures that are opposed to the company goals, by exploiting informations from the company. In particular, they are prohibited from exploiting the Company's business opportunities for their own purposes. It is irrelevant whether the exploitation of the position for own, or third-party benefit takes place. A breach of the insider prohibitions is also unlawful, and indeed because of the associated threat to the reputation of the company. However, it is not necessary for the Supervisory Board members to refrain from pursuing their own interests or that of their main or other secondary office simply because it could have a negative effect on the company. An unlawful conduct does not already exist if the member of the Supervisory Board exploits a business opportunity that he or she possesses independently of the Supervisory Board mandate and which could also be of interest to the Company for its own purposes (Selter, p. 662).

## 5. CONSLUSION

When it comes to conflict of interest, it should be noted that the members of the Supervisory Board are not professionals. Therefore, it can be expected that the members of the Supervisory Board will give priority to its other interests. In this regard, their action and the attention they are expected differ from what should be applied when it comes to the management. Directors do a very different job, requiring full professional engagement as it is the first and only job they do. The director is not tolerated by a collision of interest that would give priority to his interests towards the interests of company, as can be seen from the rule on competition ban, which rule does not apply to the members of the Supervisory Board. A member of the Supervisory Board is not in the collision of interests even when the Supervisory Board provisionally determines that a member of the Board acts as a deputy member of the Management Board. If the conflict of interest is of serious nature, the Board member should resign. If the company considers that such conflict of interest is harmful to the company and the member of the supervisory board does not resign, the general assembly may revoke it. Therefore, it is necessary to distinguish the benchmarks to be applied for assessing the responsibility of a management from the benchmarks for assessing the liability of a member of the supervisory board. Whilst the general duty of care and loyalty is more than a mere duty of loyalty, it does include the duty of loyal conduct. Negative statements made by a member of the Supervisory Board about the company, its managing directors and other bodies to outsiders, in particular to the public (business press) are therefore inadmissible. This applies in particular, if untrue facts about the company are spread or the discretion is violated in general. But even active participation in a strike will, unlike passive participation, usually amount to violation of the loyalty duty. This is especially true if informations gained by the member of the Supervisory Board are used for achievement of personal interests outside the company.



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## RESEARCH PROJECT PROPOSAL ON INFORMATICS IN EDUCATION

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### ABSTRACT

*Inefficient processes and lack of standardization in the introduction of Informatics (IT education) into the education system prompted the authors to define the project proposal for education informatization. The paper presents the analysis of the impact made by information technology (IT) on versatile changes in society. The processes used to maintain regulatory compliance of the IT education program are criticized to illustrate the ratio between efficiency and performance, and methods are suggested to increase the value of decision-making in the selection of program contents and methods of introducing informatics in education. Factors are listed that contribute to better engagement and communication, as well as strategies to increase involvement and improve communication in the process of education informatization. Case studies and research in the world theory and practice suggest that failure in introducing information process would lead to fatigue and distraction, thus increasing the probability of the incident. Recommendations are related to building an organizational culture that promotes employee engagement and improves communication through standardization and implementation of technology and educational methods. Expected results relate to more efficient use of resources leading to safer and more productive IT education.*

**Keywords:** action research, computer literacy, informatization, Intelligent Tutoring Systems

### 1. THEORETICAL APPROACH TO THE RESEARCH PROBLEM

In contemporary, and especially in future social development, education becomes the central point of total reproduction. The role of education and knowledge, especially those in the field of natural and technical sciences, is becoming increasingly important. When it comes to scientific discoveries and knowledge, it should be borne in mind that the notion of science does not mean the application of scientific knowledge promptly and without difficulties. Namely, science itself has no obligation to take care about the transfer of knowledge into educational process. Therefore, with the measures of educational policy through constant change of educational content, and modelling of work organization that would be based on permanent developmental changes, it should be possible to provide a continuous transfer of scientific knowledge into educational practice. The third technological revolution, which is discussed more and more, is not only based on natural sciences, as often emphasized. It primarily assumes a new culture expressed in new skills of thinking and living, a change in the style of work and life, and in overall expression of humanity. The third technological revolution assumes culture as the total choice of a change in a human as a social being. Changes in education must start from the needs of the 21st century, as current students will finish their working life in the middle of this century.

In outlining the vision of the next century, the essential role belongs to informatics. In our specific social conditions, it also has a role to overcome the crisis of economic and social development. Our country is far behind the highly developed countries which are gradually entering the information society. Knowledge and information, biological sources, solar energy or the so-called cutting-edge information technology with low energy consumption is the basis for the new economic and social development. The introduction of robotization and computerization overcomes stagnation in industrial development based on previous technology. It was estimated that in 1990 about 80-90% of routine production processes were controlled by computers without human involvement. The IT revolution becomes the basis for the social revolution. Informatics allows more rational and efficient operations of many sectors of human activity. It means a new qualitative leap in education, scientific work and management, thus contributing to the new quality of life. The spread of information technology prevents subjectivism and voluntarism in social decision-making and management, allowing the choice of the best alternatives in work organization, including also pedagogical work at school. Classical knowledge is not enough for the future of mankind and for development of all relevant potentials, including the intellectual potential. On the contrary, education system reform must be permanent; it will have to accentuate sharp selectivity when it comes to new knowledge about new technologies and new quality of human life and development, a highly productive economy and more efficient social development as a whole. New knowledge also includes the computer literacy, i.e. the ability to use and understand new information technology and all possible ways of its application. There are several levels of computer literacy as an essential prerequisite for more comprehensive application of IT and informatics. There are four levels which are most often distinguished. The first level of computer literacy enables technical understanding of IT. This literacy involves mastering techniques and skills of handling computers, using the keyboard for data entry or search for information. This stage is also called the stage of play, because children, while playing games, master these skills very fast and very well. The second level of computer literacy assumes the ability of programming with the language in which certain computers “speak” and which are relatively easy to master. When it comes to language, it is considered that in the near future the direct human and machine communication will be established through speech or ordinary correspondence. This level assumes not only mastering programming and using one of the program tools, but also application of computers in certain problem situations, the use of text editors in writing or database search in order to obtain appropriate information. The third level of literacy is based on solving problems by using information possessed by the modern technology. The use of information in modelling of concrete human activity presupposes a more thorough understanding of certain information and its meaning, characteristics and impact in solving specific problems. This level of literacy means a break with decision making based on “intuition”, experience, and the like. This level assumes a substantial change in current knowledge and mentality of our teachers in schools. Finally, the fourth level of literacy refers to understanding the highly productive effects of informatization. Informatization, as a new production resource and usable value, though not tangible, has linking and cohesive power that constitutes the basic leverage of economic and social development. It drives many highly productive technical and technological determined systems, but also systems that are not technical and determined, such as educational system. Namely, by informatization of schools it is possible to regulate a pedagogical activity, which naturally belongs to the so-called stochastic systems, as a complete organizational system and bring it closer to determined systems in terms of efficiency, in order to monitor the effect of each stage of the process and predict corresponding results in the output. Informatization of schools can re-establish connections of broken links between certain factors. It is well-known that schools work in conditions of constantly broken links.

Namely, schools are not organized as a complete organizational system, with teaching organized as a complete cognitive system. There is always a lack of feedback information as a measure of work order. For example, after the lesson (as a subsystem in the system), students are not aware of their accomplishments and neither is a teacher. Without knowing what student have memorized and learned, the teacher is not able to affirm positive applications of his/her work and correct the negative ones. When it comes to school, it takes three months (a quarter) to obtain unreliable results and make conclusions on achievements. Informatization means a return point in a more efficient organization of the overall pedagogical activity in schools, a more rational use of energy of all teaching factors, expanding of education sources, and faster, more efficient way to access the relevant information as a basis for more thorough and intensive education, and timely and continuous obtaining information on students' progress in the process of learning. Informatization means breaking with the current static status of a school, which is by nature a conservative institution that retains certain obsolete educational models for a long time. It is difficult for a new practice to enter schools, and when it does, it is hard to terminate it, although it has long been obsolete. In conditions of informatization of society, where knowledge and ideas are basic productive resources, a school, which used to follow the changes, should assume the role of the leader of the change. These are the new crossroads facing the education system which should be responsive and adaptable, to become a generator of changes which should initiate better work at schools and better education as a whole. It is the end of static and “quiet” schools, where rarely is anything changed, and which are often proclaimed for the best schools. We should accept the rule that the worst schools are those where nothing ever changes. The school of creativity assumes constant change and permanent restlessness. Good organization of teaching does not mean a lesson where students sit quietly and listen to the teacher, but a lesson where there is a constant creative jumble, movement, experimenting, confronting, use of various sources of knowledge, material and the like. School informatization is a major and very important social and economic task to enable students to use all possible resources and information, and to achieve appropriate computer literacy, of both students and teachers. Modernization of the teaching process through the use of IT is realized by teachers as organizers of pedagogical work at school. Of course, new responsibilities for teachers seek adequate stimulation measures in order to realize these new tasks with additional efforts. However, society cannot be indifferent to the informatization of schools because schools provide the necessary knowledge of future generations. Future production and social organization of life is inconceivable without cutting-edge IT.

## **2. RESEARCH SUBJECT**

The subject of this research is to perform the theoretical, empirical and experimental verification of efficiency of school's educational and upbringing informatization; verification of developmental educational software; to develop and verify the efficiency of computer literacy of students and teachers at all levels of computer literacy.

### **2.1. Definition of terms**

#### *2.1.1. Computer literacy*

Computer literacy implies three levels of literacy: The first level represents mastering the ability to use a computer keyboard, entering and searching data. Understanding of information technology is also established at this level. The second level represents mastering the computer language and programming ability. This stage implies using computers to solve various problem situations. The third phase involves the possibility of evaluations provided by modern IT technologies in solving specific problems. This stage implies an assessment of importance of certain information, its reliability in solving problem situations and making valid decisions that would exclude voluntarism, subjectivism and reliance on intuition and experience.

### *2.1.2. Evolutionary phases of informatization of school activities*

Informatization implies a complex introduction of computers in the organization of all aspects of educational work as well as into the overall school business (business information). Informatization of educational activities of schools is implemented through four stages which include the following activities:

Stage one implies equipping experimental schools with computers (providing computer labs and computer units), as well as training teachers and students for technical use of computers.

Stage two involves computer usage in educational process. It involves developing educational software and its experimental and empirical verification. At this stage, the type of educational software will be tested: Intelligent Tutoring Systems where computers examine, comment and direct students in acquiring new knowledge. Such software maximizes individualization of the teaching process, as students are progressing according to their capabilities. Simulation software enables students to create imaginative or realistic situations, to make decisions about them and monitor the consequences of their choices. These programs can simulate laboratory exercises.

Stage three implies installing a communication network which would connect all subjects to library resources, computer labs and databases, as well as using software as a support to the learning process. This stage involves the integration of computers into school business system, management of student information files, management of accounting, as well as making a database for more efficient implementation of pedagogical, instructive, evaluation, programme and other functions of the school principal, pedagogue and psychologist. At this stage, the classification of sources is performed in specialized teaching facilities (specialized classrooms), and based on better, more thorough information certain problems will be addressed, depending on more creative and efficient expression in the chain of different roles that will be performed during their working life. It is necessary to approach informatization and all levels of IT literacy in a comprehensive, planned manner with significant economic and social support. Some people are resisting new technology primarily because they are not accustomed to it. Technological illiteracy is the main cause of opposing the introduction of new information technology. By analyzing the dynamics of informatization of schools in some developed countries, it is possible to notice some distinguished phases. In the first stage, a smaller number of enthusiasts among teachers and students show interest. The second stage is characterized by introduction of the programme, enabling students to use one of the programming languages. In the third stage, a computer is involved in organization of pedagogical work of individual subjects. At this stage, mainly three types of educational software are being developed: Intelligent Tutoring Systems, simulation models, and computer as a learning tool. An Intelligent Tutoring System is designed to examine, comment and coach students in knowledge acquisition. Stimulation software allows students to create imaginative or real situations, choose alternatives, and then observe the consequences of their decisions. The simulation method aids in solving problem situations.

Stage four is distinguished by integration of computers into basic school activities. Computers interconnect all school subjects with library resources, a computer lab and a database.

Stage five or the top stage is the one in which complete information on school activities is complemented by linking home-school line, i.e. the relationship with external resources and databases is intensified. School is connected to all entities of its environment with the support of modern data processing technology.

Informatization of schools and educational processes is still in the centre of attention in developed countries. Most European countries implement programmes for the complete informatization of educational organizations. It is estimated that higher education is very well supplied with appropriate computers. Some 34 years ago (in 1984), 400,000 microcomputers were installed in schools across the U.S. The dynamics of introducing computer technology into school is accelerating. In 1980, only 21% of American schools had one or more computers, but two years later (in 1983) the percentage increased to 86%. It is believed that today all high schools in the United States have completed informatization of the educational process to a greater or lesser extent, because without it they cannot fulfil their study obligations. According to a study analysis of computer involvement in solving certain problems, 67% of the time a computer was used in programming lessons, 18% of time in management of the teaching process, and 15% for word processing, simulation, classroom experiments, and the like. American company IBM and the pedagogical service of the Institute for Improving the Quality of Education and Training took a sample of 89 high schools and 12 teacher training centres in three US states (California, New York and Florida) and carried out experimental checks of the possibilities to connect schools and their surroundings (in addition to their complete internal informatization). Each school was provided with 15 personal computers and a variety of software material. The computer network linked information resources of all schools from the sample, providing information search services across the country, electronic mail and software exchange. The results of this experiment will soon be revealed, but the first results indicate that the use of information technology had a better effect on educational work in schools. Education in our country lags far behind education in other countries. Computers in schools are mainly used at the stage of play, mastering the ability to use a keyboard, and sometimes for programming. However, our falling behind should be used as our advantage, because we could avoid some hasty steps when it comes to informatization and computer literacy. With a coordinated action and versatile social support, it is possible to make more radical steps in informatization of schools, development of computer software, test banks, hemeroteque, reference libraries, specialized didactic material and didactic teaching systems, and the like.

### **3. THE IMPORTANCE OF RESEARCH**

There have been significant funds invested for the procurement of computer equipment for elementary and secondary schools several years ago. Although the world has advanced pretty much in computer application in education, we have made the first steps by procuring the right equipment. However, the informatization of the educational process presupposes planned training of teachers and students, i.e. dissemination of appropriate computer literacy. Further significant efforts in informatization of school educational activities are related to the development of various software programs that simulate corresponding processes or development of complex software that imitates creative work of students during classes. The development of complex software programs assumes the engagement of teams of experts of different profiles, followed by implementation of experimental and empirical verification of already developed software. One of the reasons proposed in the project is based on historical discussions and conclusions of The 2nd International Congress of UNESCO on Education and Informatics held in Moscow (Book 2, Vol. 3, 1998). Namely, many countries have initiated IT education of students in elementary school: Russia, from 1st to 7th grade with 34 lessons per year, and from 7th to 10th grade with a fund of 68 lessons, alternatively, 136 lessons per year; Belgium (French speaking region), recommended for the age of 6 to 12, and at the age of 12 to 16 as a compulsory subject; Belgium (Flemish region), pilot projects for the age of 6 to 12, and from 12 to 16 as a compulsory subject; Denmark, at the age of 6 to 12 and at the age of 12 to 16 as a compulsory subject; France, as an optional subject at the age of 6 to 12, and at the age of 12 to 16 as a compulsory subject; Germany, pilot projects; Greece, pilot projects; The

Netherlands, practical computer usage (60% of the population); Ireland, as an optional subject at the age of 6 to 12, and at the age of 12 to 16 as a compulsory subject; Luxembourg, pilot projects for five year olds, and at the age of 12 to 16 as a compulsory subject; Spain, experimental projects, and with the adoption of the new law as a compulsory subject; United Kingdom, as a compulsory subject at the age of 6 to 12, as well as at the age of 12 to 16.

#### **4. RESEARCH OBJECTIVE**

The objective of this research is to theoretically elaborate, and experimentally and empirically verify the complex system of informatization of the educational process at school: to experimentally and empirically verify already developed educational software of the individual school subjects, and the information system of the school as a whole.

#### **5. RESEARCH TASKS**

Within the scope of this objective there are relevant general and specific research tasks, as follows:

General research tasks: elaborate the concept of informatization of school educational activity, including a business information system with appropriate databases; develop appropriate educational software and perform its empirical and experimental verification; develop computer literacy programme for students and teachers and verify it empirically.

Specific research tasks:

1. Develop and experimentally verify the complex system of informatization of school pedagogical activity;
2. Identify and empirically verify the concept of equipping computer labs in schools;
3. Develop educational software and experimentally verify its pedagogical effects;
4. Develop operational programmes of computer literacy for students and teachers.

#### **6. RESEARCH HYPOTHESES**

In accordance with basic research tasks, the following research hypotheses have been set:

1. Complex information system will significantly contribute to a more efficient organization of pedagogical and other education activities;
2. There are positive attitudes and opinions of students and teachers about the usefulness of equipment in a computer lab;
3. Developed educational software will increase the efficiency of the teaching process.

#### **7. RESEARCH INSTRUMENTS**

1. Student achievement tests from individual subjects  
For initial-state and final-state measurement there will be several versions of achievement tests, for each educational software two tests will be made: one for initial-state measurement and the other for final-state measurement.
2. Scale for measuring attitudes according to different models of organization of teaching  
For the empirical verification of educational software, a questionnaire will be made in the form of a 5-point Likert Scale to measure positive or negative attitudes towards different teaching organization models. Namely, students will be required to evaluate lessons with application of educational software as well as lessons dominated by classical aspects and teacher techniques. Possibly more positive attitudes towards the lessons with applied educational software can be attributed to the positive impact of software in organization of teaching based on students' positive attitudes and interests.
3. Questionnaire for measuring teachers' attitudes and opinions on educational software

For empirical verification of educational software, a special 3-point scale will be created for the purpose of measuring its didactic and methodological justification.

4. Questionnaire for measuring the effects of a complex information system model on pedagogical results at school

An inventory questionnaire will be compiled to evaluate the information system effects, which will be composed of a record list, in which the respondents will first state the presence or absence of a certain feature (quality) of the information system and then evaluate each positive feature in a 5-point scale. In this way, not only will the inventory of positive features be performed, but the intensity of certain values (qualities) on a 5-point scale.

5. Inventory of attitudes about the information system as desired in school

To assess the validity of the information system model introduced into the school, a questionnaire will be compiled in the form of a 5-point Likert Scale. It will be structured in two parts with an equal number of items. In the first part, respondents will be asked to estimate which values information system should contain and which pedagogical effects should be expected with its application. In the second part, the realized effects in E and K schools, as units of research, would be evaluated. A possible match between the assessment of the system as it should be and the system as it is in E schools would be in favour of better quality of the information system.

6. A record sheet for recording the results achieved in E and K schools as units of research

After a one-year application of the information system in experimental schools, the application of the Expro facto<F255> experiment will determine the achieved results in E and K schools. This record sheet will contain the results of educational work in individual subjects, and the results achieved in the realization of programme, pedagogical, instructive, evaluation, counselling and other functions of pedagogues, psychologists and principals. This record sheet will cover recording of results and their monitoring in other areas of pedagogical activity that were involved in monitoring through the information system and which are expected to have better pedagogical effect compared to schools (K-Group) where this system was not introduced. Possibly better results achieved in the E group can be attributed to the effect of the experimental factor, i.e. to complex information system which would be introduced.

## 8. METHODS OF STATISTICAL ANALYSIS

For statistical data analysis, testing of the set hypotheses, and the drawing conclusions, the following statistical procedures will be used:

- a) Calculating the arithmetic mean of the results after a more objective testing of knowledge by applying knowledge tests - the initial-state and final-state measuring in the E and K groups (experimental verifications) of the educational software;
- b) Chi-square test: to test the difference between data expressed in frequencies (E and K groups);
- c) Rank Sum Test: to test differences in ranking scale of estimated values (group E and K);
- d) Kruskal–Wallis<sup>1</sup> <F255> test: for testing the differences in rankings between three and more data sets;
- e) Rank correlation test: to calculate matching of the series in the results ranking of the E and K groups.

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<sup>1</sup> The Kruskal-Wallis test is a nonparametric (distribution free) test, and is used when the assumptions of one-way ANOVA are not met. Both the Kruskal-Wallis test and one-way ANOVA assess for significant differences on a continuous dependent variable by a categorical independent variable (with two or more groups). In the ANOVA, we assume that the dependent variable is normally distributed and there is approximately equal variance on the scores across groups. However, when using the Kruskal-Wallis Test, we do not have to make any of these assumptions. Therefore, the Kruskal-Wallis test can be used for both continuous and ordinal-level dependent variables. However, like most non-parametric tests, the Kruskal-Wallis Test is not as powerful as the ANOVA.



Within the study project, after more complete instrumentation is created and verified, more concrete statistical procedures and patterns will be established which will be used to calculate certain values.

## 9. RESEARCH SAMPLE

The experiment, as stated above, is planned on the basis of the methodology of pedagogical research, as a project on experimental and empirical level. It is a group experiment with factor rotation. Namely, it is about more factors, as objectives of the experiment, which are introduced into the same group, in other words, the factors rotate between groups, departments of the same grade in the school in which the experiment is being conducted. Action research is very popular in the field of education because there is always room for improvement when it comes to teaching and educating others. Of course, there are many kinds of teaching methods in the classroom, but action research works well because the cycle provides an opportunity for continuous thinking. In all areas of expertise, the objective of action research is to improve the process. Action research is also useful in areas of teaching practice which is to be explored or in situations where improvement is continuous. Having a closer look at the cycle of action research of the set problem one can see that the process begins with the recognition of the problem. Then, you have to make a plan and implement it. This is the part of the process where the action takes place. Once the plan is implemented, you will see if the process works or it does not. After a period of observation, the whole process of action research will yield certain results.

## 10. CONSLUSION

The broad objective of this activity is to review and evaluate the process of policy innovation, as well as public and private initiatives aimed at promoting the development, distribution and use of digital learning resources for the sector of education. This way, the activity will gather evidence about the following:

- How the Republic of Croatia can start inducing innovations in education related to information technology which includes digital learning resources, involved participants and processes, knowledge-based learning and procedures, and criteria for assessing progress and outcomes;
- Which factors lead to the success of policies aimed at encouraging information technology-based education innovations, particularly those related to production, distribution and use of digital learning resources, together with the inclusion of users in the production process and new stakeholder such as industry and media companies;
- Innovations related to digital learning resources conducted by students and teachers, such as innovative production and use of digital learning resources, and the response of educational systems to such innovations.

The best practice for teachers should be based on STEM<sup>2</sup> areas which involve a research approach in teaching basic scientific concepts. However, teachers often lack the ability to create an authentic research environment where issues and hypotheses are not developed in a simple, linear way by individual researchers, but rather in dynamic, interactive collaboration that integrates multiple perspectives. Results, discussion and implications: The project report must describe the outcome of the project and its assessment. The results have to be discussed, including descriptions of suitable analysis of the data used. Relevant implications for further

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<sup>2</sup> Study programmes in STEM areas of science include study programmes in biotechnical, technical, biomedical and natural sciences, and study programmes that confer academic or professional titles of a bachelor of information technology, business informatics, information science and informatology.

research and practice must be obtained from these data and described in the report. Lack of time and scarce support (technical and pedagogical) identified from the previous experience are the two most prominent limitations. Staff report limitations of resources used in education in recent times and suggest prioritization of appropriate resources. Flexible training, exchange of practice among peers, and recognition for efforts are also reflected in contributions given to others. Combining this survey with other information gathered from reviews of the existing IT infrastructure for teaching and learning will provide a more comprehensive analysis and understanding key issues that point to challenges and opportunities in the future.

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## PERSONS WITH DISABILITIES IN THE LABOUR MARKET OF THE CITY OF SPLIT: REALITY AND PERSPECTIVES

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### ABSTRACT

*Unemployment of persons with disabilities is a widely recognised problem, also present in the Republic of Croatia. Therefore, it is important to make efforts to improve the position of persons who are particularly "sensitive" and "vulnerable" in the labour market, which is certainly the case for persons with disabilities. Their employment is influenced by a number of factors, such as the potential of a country's economy, aggravating factors such as prejudice, spatial and psychological barriers, etc. As compared to the rest of the population, there are differences with respect to persons with disabilities, not only in employment but also in personal income and other activities. Despite the stimulating measures, in the Republic of Croatia it is difficult to recruit persons with disabilities who often fall under the burden of family and social welfare. Such persons are last to get a job and first to lose it. For this reason, vocational training and employment of disabled persons is a basic measure of their protection. In this paper, an overview of the research results on the employment of persons with disabilities in the city of Split, conducted in August 2016, is presented. The research deals with the implementation of the Act on Vocational Rehabilitation and Employment of Persons with Disabilities. To this end, opinions and attitudes of persons with disabilities have been explored regarding their employment problems and shortcomings of the aforementioned Act. A survey was used as a research method. The research sample included an age group of 20 to 61, planned in accordance with the Report of the Croatian Institute of Public Health (2015). A sample of 49 respondents was realised in cooperation with NGOs dealing with persons with disabilities in the City of Split. According to the research results, most respondents believe that employers are not familiar with the difficulties that persons with disabilities face. The most common problems with their employment are the lack of employers' understanding, stereotypes about work efficiency, architectural barriers, few jobs available, and a lack of qualifications.*

**Keywords:** *persons with disabilities, labour market, rights of persons with disabilities, legal regulations*

### 1. INTRODUCTION: DEFINING DISABILITY

The emergence of disability studies as an academic discipline is inextricably linked to the strengthening of the disability rights movement which began in the 1970's. Within the scope of the aforementioned discussions, a shift in the society's attitudes towards persons with disabilities has been observed, which have changed particularly in the context of employment and the labour market (Barnes, Oliver, Barton, 2002; Oliver, 2009; Barnes, Mercer, 2010; as cited in Oliver, Barnes, 2010, p. 547). Over the past decade, the topic of recognising the importance of recruiting persons with disabilities has been increasingly addressed within the

policies and practice of many countries. Despite the growing interest, however, the employment rate of people with disabilities unfortunately remains much lower than that of people without disabilities. The view that employment is the preferred outcome for persons with disabilities is not universal, especially concerning persons with intellectual and developmental difficulties or mental illness. Efforts to boost the employment of persons with disabilities primarily involve making them, as well as their families, caregivers and employers, aware of the possibilities of successful employment of persons with disabilities based on appropriate grants/subsidies. To this end, numerous public policies are created, aiming to find an effective way of recruiting persons with disabilities in typical work environments. Therefore, emphasis is also placed on overcoming the employers' misconceptions regarding the capabilities of disabled persons, and in this regard more work should be done on counselling and financial assistance (Boeltzig-Brown, Kiernan, Pilling, 2013, p.168). Employment of persons with disabilities is affected by complex and limited economic opportunities of a particular country, in addition to existing prejudices, as well as spatial, psychological and social barriers (Leutar, Milić – Babić, 2008, p. 162; Grant, 2013). Generally, persons with disabilities have a higher unemployment rate, lower average income, are less involved in out-of-home activities, have limited access to means of transport and lower quality of life. Within the social model, the social community is required to provide better conditions and services to persons with disabilities and thus enable them to equally participate in community life (Samaha, 2007; Sivrić, Leutar, 2010, p. 242). This model was preceded by the individual model, which places focus on the person requiring help and medical treatment aimed at his/her recovery, and in which the dominant role is played by experts, while institutions and housing units intended for persons with disabilities are mostly closed type or away from everyday social life. Within this model, the individual does not have equal opportunities to participate and make decisions about one's own life. As contrary to this approach, today, there is growing advocacy for integration, which is crucial for inclusion in society (Albert, 2004; Mašović, 1996, p. 11). With the shift from its classification of impairments, disabilities and handicaps (ICIDH) to the International Classification of Functioning, Disability and Health (1986), the World Health Organization (WHO) conceptualises "disability" as an outcome of interactions between health conditions (diseases, disorders and injuries) and negative impacts of the social environment (Leutar, Štambuk, 2006, p. 91). Furthermore, the 1994 United Nations Standard Rules on Equalisation of Opportunities for Persons with Disabilities emphasise the need to address the problems faced by people with disabilities. Under the term "disability", which is seen as equivalent to "impairment", this document summarises a great number of different functional limitations occurring in any population in any country of the world, while such impairments may be permanent or transitory in nature. The term "handicap" is defined as the loss or limitation of opportunities to take part in the life of the community on an equal level with others and describes the encounter of the person with a disability and the environment. The purpose of this term is to emphasise the shortcomings in the environment and in many organised activities in society which prevent persons with disabilities from participating on equal terms. The term "equalisation of opportunities" means the process through which the various systems of society and the environment are made available to all, particularly to persons with disabilities (Rački, 1996, p. 91). The World Health Organization revised the existing document and in 1999 issued a document under the title International Classification of Impairments, Activities and Participation (ICIDH - 2), which omitted the stereotypical terms of "disability" and "handicap" and introduced the concepts of "activity" and "participation" instead. Here impairments are seen as significant deviations or loss in body structures, or significant deviations or loss in particular physical or mental functions of a person. When it comes to activity, it denotes the nature and extent of person-level limitations in performance, while participation refers to restriction of involvement in social situations (Marinić, 2008, p. 203). At the same time, the first item of the Declaration on the Rights of Persons with Disabilities states

that a person with a disability is any person who, as a result of a physical and/or mental impairment, either permanent or transitory, present or future, congenital or acquired due to any factor whatsoever, has lost or deviates from the expected body structure or physical/mental function and has limited or inadequate ability to perform certain activities in the manner and extent considered to be common for people in a particular environment (Declaration on the Rights of Persons with Disabilities, 2005). According to the theory of expanded social justice, this can be seen as a form of oppression, i.e. a specific type of marginalisation that exceeds the scope of discrimination, as it involves the role of institutional factors in determining human chances for social success. For example, women with developmental disabilities are socially unrecognised and endangered, stigmatised, and experience a kind of public and institutional violence which denies them both equal and adequate rights, especially to decent work and life. Thus marginalisation refers to structural and institutional relations that define "who is useful and who is obsolete" (Young, 2005; as cited in Brstilo, Haničar, 2011, p. 88). It must be noted that social attitudes towards persons with disabilities have generally changed throughout history, evolving from a charity model which focused on institutions, homes and special schools that mostly emphasise and encourage the dependence/inability of persons with disabilities. Similarly dominant in the course of history was the medical model that primarily takes into account the medical impairment, its degree and the need for adequate intervention. As opposed to these models, the social model suggests that disability is not an individual's problem and that it is in fact social barriers that make persons with disabilities unable to equally compete with people without disabilities. The social model therefore points out that the society is required to remove these barriers and ensure people with disabilities equal rights and full participation in their social environment (Turčić, 2012, pp. 111-112). In the Republic of Croatia precisely the social model is increasingly present, which entails the achievement of conditions that will enable the exercise of every person's right to choice and quality of life. This includes ensuring an adequate environment through accessible buildings, public areas, transportation, services and communications. In the segment of employment, the greatest problem, in addition to physical barriers, are the prejudices regarding the capabilities and work efficiency of persons with disabilities. With respect to health care, a special problem is the unavailability of certain diagnostic and therapeutic services, as well as the existing standard of mandatory physical therapy and rehabilitation. It is therefore necessary to ensure equal access to services in order to enable full inclusion in community life (Narodne novine, 2007, p. 8-9). To this end, the National Strategy for Equalisation of Opportunities for Persons with Disabilities (2007-2015) has recently been adopted. As a member of the United Nations, the European Union and the Council of Europe and a signatory to all relevant conventions and standards in the area of social and economic welfare of citizens, the Republic of Croatia has taken on the obligation to protect and promote the human rights of persons with disabilities so as to enable them to equally participate in civil, political, economic, social and cultural areas of life. The Republic of Croatia confirmed its commitment to full achievement of all basic human rights of persons with disabilities by being the third country in the world to sign the 2007 United Nations Convention on the Rights of Persons with Disabilities, thus expressing its desire to follow the path of progress by fully honouring the principles of the Convention.

## **2. INTEGRATION OF PERSONS WITH DISABILITIES IN THE LABOUR MARKET – FROM INCLUSIVE EDUCATION TO THE LABOUR MARKET**

From a sociological point of view, the given topic represents an area of interest of sociology of inclusive education, especially since the 1990s, when under the influence of UNESCO governments began to adopt the idea of "education for all". The key assumption was based on the idea that development of human capital leads to individual and national competitiveness on the market.

Education of persons with disabilities had up to then been referred to as special education. On the other hand, as early as in the 1980s sociological research showed that pupils should not be separated but rather included in regular education (Tomlinson, 2017). This debate originally started around the position of children who were established to have "special educational needs" (SEN). Therefore, it was first termed a debate on integration/segregation and focused almost exclusively on where such children should be educated; namely in special or in regular schools (Oliver, Barnes, 2010, p. 547). The relative lack of general sociological interest for the aforementioned topics is a result of a number of factors: a relatively small number of pupils involved in special/inclusive education, the domination of psychological and medical approaches claiming that differences in abilities are objective and measurable, as well as the widely accepted idea of "benevolent humanitarianism", which focuses on caring for the unfortunate ones by doing all that can be done (Tomlinson, 2017). On the other hand, a causal link has been established between special education and the risk of a lower level of education and employability (Powell, 2006). When it comes to empirical research, their results have largely pointed to the predominance of the working class and ethnic minorities in special education. This was due to definitions of terms and to measuring instruments that were based on "non-normative categories", i.e. on needs that could not be established objectively, but rather depended on experts' value judgements (Tomlinson, 2017). Greater sociological interest in special education since the 1980s meant an analysis of an increasing number of SEN persons, their socio-demographic features and their potential (in)abilities. As far as contemporary trends are concerned, a large number of SENs leave education, complete lower levels of education, are employed temporarily or occasionally, while most of them remain unemployed. High unemployment rates currently represent the most important economic and social problem for almost all EU member states. Certain "vulnerable groups" are in a more unfavourable position in this respect, i.e. long-term unemployed, young people, the elderly population of the unemployed, women, members of ethnic minorities and persons with disabilities in particular (Kiš – Glavaš, 2009, p. 300). It is therefore evident how important it is to apply sociological theories and concepts in understanding inclusive education and attempting to mitigate educational and social inequalities, i.e. conditions that encourage or limit such practice (Carrier, 1986; Tomlinson, 2017). Global competitiveness makes governments and corporations set their educational requirements ever higher. This results in an increasing number of pupils and/or students who are unable to meet such requirements. In order to prevent them from literally "dropping out" of the education system, the number of various SENs increases, with an aim of implementing an individual approach to allow greater mobility within the education system and academic qualifications. There is a noticeable increase in the number parents, especially among members of the middle class, who request SEN themselves, fearing the risk of their children's academic failure (due to ADHD, milder hearing and speech problems, etc.), for the simple reason that higher academic qualifications imply better jobs (Tomlinson, 2017). Consequently, the economy gains educated workforce, which it uses as it pleases. As a result of robotisation and automation, the number of jobs available is rapidly decreasing, especially at the expense of SENs with lower education levels, as those more educated take even less paid jobs due to the risk of unemployment (Frederickson, Cline, 2002; Joy, Murphy, 2012; Andreozzi, Pietrocarlo, 2017; Booth, 2017; Zappella, 2017). Digital Taylorism is an increasingly present form of management, based on creating circumstances and work processes in which cheap labour can perform various tasks across the world (Spencer, 2017), as well as the growth of precarious work, which is characterised by insecure and poorly paid jobs without union protection (Kalleberg, 2009; Foti, 2017). In this context, inclusive education imposes itself as a solution to the crisis of market legitimacy, with the understanding that those who use their abilities and opportunities are finally employed (Tomlinson, 1988, p. 48; Tomlinson, 2017). In a situation of a major economic crisis affecting many individuals both around the world and in the Republic of Croatia alike, as evidenced by data on the significant growth of

unemployment, it is important to take actual steps to improve the position of persons with disabilities, as a particularly "vulnerable" group in the labour market. In this context, the United Nations Convention on the Rights of Persons with Disabilities should be mentioned again. The Convention was, namely, the first human rights document adopted in the 21<sup>st</sup> century, as well as the fastest-adopted document in the history of international regulations. Accordingly, it should be noted that the Republic of Croatia signed the Convention on March 30, 2007, and ratified it on August 15, 2007, while the Convention entered into force on May 3, 2008. Furthermore, the Convention focuses on the rights of persons with disabilities, but also addresses the society as a whole and the need to enable every person with a disability on the Croatian labour market to contribute to that society in accordance with their skills and abilities. Available data, on the other hand, testifies to very low employability of persons with disabilities, both in the open labour market and within sheltered workshops (i.e. social enterprises) and other subsidised employment schemes. Rehabilitation and employment of persons with disabilities represent a complex area that deserves special attention, given the fact that work offers a sense of personal, family and social utility and inclusion. The process of training for work as well as recruitment of people with disabilities represents the best form of their social protection. A person with disabilities thus attains the status of an active society member who independently achieves his/her social and economic position and thus actively contributes to the overall social well-being. In achieving this, they need help from the society, which is required to fulfil its part of the duty. Although the ideal path of rehabilitation would be work in a work centre → sheltered workshop → open-market employment, it is clear that a certain number of people with more severe and multiple impairments will not be able to cross that ideal path (Babić, Leutar, 2010, pp. 195-198). Numerous researches show that employed persons with disabilities (including those with more severe disabilities) are generally highly satisfied with their work and report on positive relationships with their co-workers and superiors. It is possible to conclude that unemployment supports social exclusion. Although there is no generally accepted definition of social exclusion, it can be described as a multidimensional phenomenon that weakens the relationship between an individual and a community (Bayley, Gorančić-Lazetić, 2006, as cited in Kiš – Glavaš, 2009, p. 300). Unemployment entails social exclusion, and the concept of social exclusion entails a cycle of social degradation in which long-term unemployment leads to poverty and social isolation that again lead to marginalisation in the labour market (Šverko et al., 2004). Therefore, affirmative social inclusion measures are necessary, as they represent an important link in the labour and employment system (programs aimed at empowering persons with disabilities through education and training), enable the choice of work and employment with the possibility of self-employment and ensure ongoing work support and specialised planning of work requirements (Gotovac, 2003).

### **3. MAIN PROVISIONS OF THE ACT ON VOCATIONAL REHABILITATION AND EMPLOYMENT OF PERSONS WITH DISABILITIES AND THEIR IMPLEMENTATION**

On the first day of 2014, the new Act on Vocational Rehabilitation and Employment of Persons with Disabilities entered into force (Narodne novine, 2014). The said Act, aimed to protect persons with disabilities, lays down their rights concerning vocational rehabilitation, employment and work, work of persons with disabilities in the open labour market and under special conditions, establishment, activity and administrative and expert bodies of the Centre for Vocational Rehabilitation, integrative workshops, sheltered workshops, measures to support employment and work of persons with disabilities, the activity and competences of the Institute for Disability Certification, Vocational Rehabilitation and Employment of Persons with Disabilities and liability for violations of the provisions of this Act. These statutory provisions apply from 1 January 2015, as do all rights and obligations of employers arising from the mentioned Act.

The set period for full implementation of the Act should enable the adjustment of the existing system and the preparation of employers for the new system of vocational rehabilitation and employment of persons with disabilities. Persons with disabilities may be employed in the open labour market or under special conditions, with the obligation of the employer to ensure a reasonable adjustment of the workplace. The Act namely prescribes the obligation for all employers having a minimum of 20 employees to recruit persons with disabilities (so called quota employment). An employer may meet the quota requirement by hiring a prescribed number of persons with disabilities; by concluding one or more business cooperation agreements with a self-employed person with a disability, the total value of which is equal to at least the minimum monthly salary of every person with a disability that the employer would have to hire within the prescribed quota; by providing curricular apprenticeship to pupils with developmental difficulties or students with disability, in which case four apprentices are recognised as one person with a disability employed; by providing apprenticeship to workers as part of their vocational rehabilitation, in which case two apprentices are recognised as one person with a disability employed; by concluding one or more service contracts with students with disabilities with a full-time student status, under which the total labour cost recognised equals at least the minimum monthly salary of each person with a disability that the employer would have to hire within the prescribed quota; by providing vocational training without entering into an employment relationship for persons with disabilities, with four such persons being recognised as one disabled person employed, or by providing one or more scholarships for persons with disabilities for regular education, the total value of which is equal to at least the minimum monthly salary of every disabled person that the employer would have to hire within the prescribed quota. In the context of this paper, a distinction must be made between physical impairment and disability within the existing legal framework, as the concept of disability tends to be superficially used in everyday life and unjustifiably extended to all cases of physical impairment. The general term "disability" does not always mean a decrease or loss of work ability. For this reason, it is necessary to distinguish between the legal definition of disability and the legal definition of physical impairment as a prerequisite for the recognition of certain, but also different rights. According to the 2014 Act on Vocational Rehabilitation and Employment of Persons with Disabilities, "a person with disabilities" is any person with physical, sensory or mental impairment, resulting in a reduced ability to meet one's own needs of daily living, which is permanent or lasts over a period of at least twelve months. The emphasis here is on "reduced abilities to meet one's own needs of daily living". The same Act provides that "a person with a disability with decreased work capacity" is a person whose impairment, as compared to an unimpaired person of equal or similar age, equal or similar education, in equal or similar working conditions, on an equal or similar job, results in a reduced ability to obtain work training, become employed and work in the labour market under general conditions, which is either permanent or lasts over a period of at least twelve months. The Act further provides that "a person with a disability with decreased work capacity" may also be a person whose work performance is within expected limits, but based on reduced actual and estimated general abilities of such persons, it is assessed that the legal status of a person with a disability is to be attributed to them in the interest of preserving their physical, sensory and mental abilities. As opposed to the Act on Vocational Rehabilitation and Employment of Persons with Disabilities, the 2017 Pension Insurance Act defines two types of disability: "reduced work capacity" and "total work incapacity". Reduced work capacity is established and exists when, due to permanent change of one's health condition that cannot be remedied by a medical treatment, the work capacity of an insured person is reduced by more than a half compared to a physically and mentally healthy insured person of the same or similar level of education and ability. Total work incapacity is a more severe degree of incapacity, and it is established and exists when, due to changes of the insured person's health condition that cannot be remedied by medical treatment, there is a total



and permanent loss of work ability. In contrast to such apparently different interpretations of disability, the Pension Insurance Act defines physical impairment as a loss, major damage or significant injury of a particular organ or body part, which limits normal body activity and requires greater efforts in meeting the needs of daily living, regardless of whether the impairment causes disability or not. Disability and physical impairment thus represent two different conditions and two different terms that may coincide, but also may be completely independent of each other. Physical impairment may, depending on its severity, cause disability, but does not as a physical impairment in itself necessarily represent a disability. Furthermore, pursuant to the legislation in force, disability does not necessarily mean the existence of physical impairment.<sup>1</sup>

#### **4. METHODOLOGICAL AND EMPIRICAL ASPECTS OF THE RESEARCH**

Changes in modern society over the last thirty years, such as the process of globalisation, but also new insights of social sciences on the possibilities of persons with disabilities, have resulted in a shift in attitudes towards persons with disabilities and in creating of new conditions for their improved positions in society (Najman-Hižman et al., 2008, p. 73). Precisely due the above-mentioned problems, the interest has been recognised in studying the position of persons with disabilities in our society. With this in mind, we also determined the subject of our research, which concerns the employment of persons with disabilities in the city of Split. The general objective of the research was to analyse the implementation of legal provisions / regulations on the employment of persons with disabilities. Given the general objective, the following specific objectives were established: 1. to examine the views and attitudes of persons with disabilities on the main provisions, advantages and shortcomings of the new Act on Vocational Rehabilitation and Employment of Persons with Disabilities (2014); 2. to examine the opinions and attitudes of persons with disabilities on the problems and challenges they face with respect to employment. Our research hypotheses involved the following assumptions: persons with disabilities are acquainted with new Act; the adoption of the new Act affected a change in the employment status of persons with disabilities; employers are not sufficiently familiar with the problems of persons with disabilities; the participation of persons with disabilities in the sphere of public decision-making is insufficient. The research method used was a survey, which was conducted by means of a questionnaire including closed- and open-ended questions. The research sample included people in the age group of 20 to 61 in the city of Split, and was planned based on a Report of the Croatian Public Health Institute from 2015. A sample of 49 respondents was realised with the help of NGOs dealing with people with disabilities in the Split area. Considering the subject of the research, it was difficult to reach a larger number of persons with disabilities willing to express their opinions and attitudes regarding the Act concerned. Respondents were made familiar with the objectives and purpose of the research.

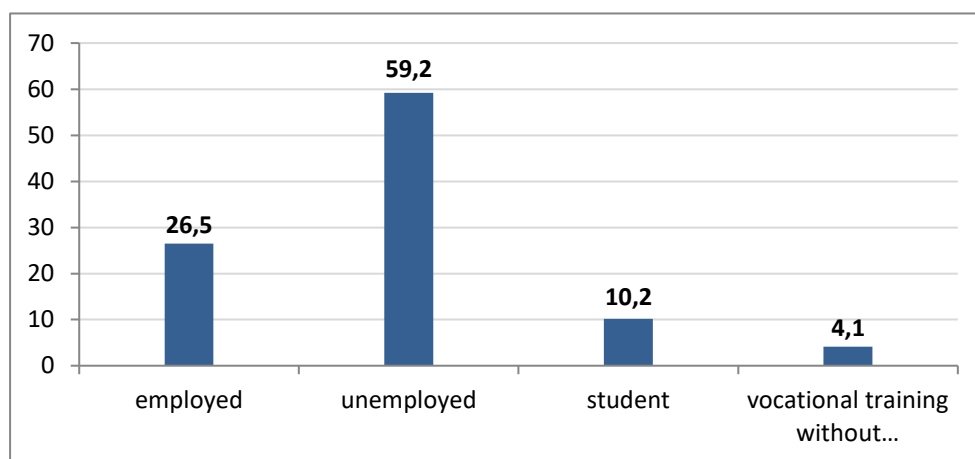
##### **4.1. Socio-demographic characteristics of respondents**

According to the 2015 Croatian Public Health Institute report, 57,314 persons with disabilities live in the Split-Dalmatia County, of which 34,108 are men (60%), and 23,206 are women (40%). Persons with disabilities make up a total of 12.9% of the county's population. Over half of them (52%) are in their working age. According to available data on education, 55% of persons with disabilities either lack formal education or have completed only primary education, 36% have secondary education and 5% have an academic degree. No more than 4% of persons with disabilities received special forms of education. Data in the recently established database of employed persons with disabilities reveal that there are 1,331 employed persons with disabilities (employed, temporarily unable to work) in the Split-Dalmatia County, 63% of which are male and 37% female. It is evident that men with disabilities tend to find employment more easily, as clearly indicated by the 2014 share of employed men.

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<sup>1</sup><http://www.uir-zagreb.hr/pravno-savjetovaliste-hr/cesto-postavljana-pitanja/48-tjelesno-ostecenje-i-invalidnost>

With regard to the type of disability, persons with intellectual difficulties tend to find employment most easily, followed by persons with physical disability and multiple combined impairments, whereas persons suffering from hearing and verbal communication disorders and those suffering from chronic illnesses face most difficulties in finding work. Persons with disabilities are most commonly employed as shop assistants, low-qualified workers, economic technicians, car mechanics, cooks and drivers. The research involved 63.3% men and 36.7% women (N=49). Based on their age, the respondents are grouped in five categories: respondents in the first category are aged 20 to 24 (24.5%), in the second 25 to 29 (22.4%), in the third 30 to 40 (33.3%), in the fourth 40 to 50 (9.8%), and in the fifth, the respondents are aged 51 or older (10.2%). With regard to levels of education, 2% of respondents completed primary education, 77.6% acquired secondary education, 12.2% hold a bachelor's degree, 6.1% hold a master's degree, and finally 2% have a master of science or doctoral degree. These figures show that the majority of respondents completed secondary education. As far as their employment and/or education status is concerned, 26.5% of respondents are employed, 59.2% are unemployed, 10.2% are students, while 4.1% are in the course of vocational training without entering into an employment relationship (see Chart 1). The respondents are mostly employed in the service sector (40%).



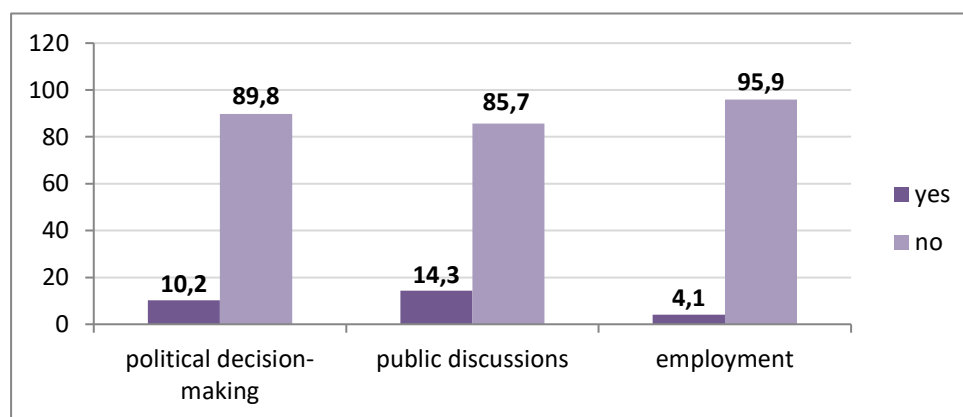
*Chart 1: Employment status of respondents (%)*

The Croatian government recognises NGOs and non-profits as competent and expert partners in policy making, and supports the development of partnership in decision-making processes in order to protect the rights and dignity of persons with disabilities. As the National Strategy for Equalization of Opportunities for Persons with Disabilities was first introduced, the Croatian Register of Associations included a total of 315 registered associations dealing with the needs of people with disabilities. The development of international cooperation is of particular interest to persons with disabilities and also allows for active participation and contribution of these associations. Direct exchange and sharing of experiences is essential for fostering general welfare and solidarity (Narodne novine, 2007, pp. 52-55). Regarding membership in associations, 91.8% respondents are members of such associations, 4.1% are not current members but are considering membership, whereas 4.1% do not do volunteer work and or show any desire to. These figures indicate that affiliation to such associations is highly significant for a majority of the respondents.

#### **4.2. Awareness and attitudes on inclusion of persons with disabilities in realms of labour market and public and political decision-making**

One of the main causes of high unemployment rates among persons with disabilities is a false yet strong belief that these people are either unable to work or unproductive. Moreover, many employers are unfamiliar with work aids and equipment designed for the disabled persons and

the channels through which they can reach qualified workers with disabilities. Certain employers find their reasons for not employing the disabled persons in negative past experiences. If perspective employers have no inclination towards people with disabilities, it is likely that the latter will never have the opportunity to develop and reach their full potential. Research on reluctance of employers to recruit persons with disabilities is rare and of limited scope (Uršić, 2003). The results of this research indicate that the inclination of employers to offer a position to persons with disabilities correlates with the type and size of enterprise, past experiences with employment of these workers and personal experiences with persons with disabilities. Most respondents participating in this research (95.9%) consider employers to be insufficiently informed on the problems faced by people with disabilities, whereas only 4.1% believe the opposite. 65.5% of respondents consider the lack of formal qualifications to be crucial factor in employment, while 28.6% believe it to be only relevant but not necessarily decisive. Unfortunately, over the half of the respondents (57%) were unfamiliar with the Act on Vocational Rehabilitation and Employment of Persons with Disabilities. In comparison to past results, up to 95.9% of respondents claim that finding employment was not facilitated by the implementation of the new law. Only a small number of respondents consider the new Act adequately drafted and properly implemented. Research results do not support two of the hypotheses, whereas the hypothesis on insufficient familiarity of employers with the problems of people with disabilities has been confirmed. Considering the fact that over half of the respondents were not informed about the implementation of the new law, it can be concluded that the majority were unfamiliar with positive changes in legislation concerning persons with disabilities. Elements of political engagement are present in all walks of life. On a daily basis we encounter situations in which we need to make a decision by weighing the pros and cons of our choices and estimating whether we will reach our goal with minimum collateral damage. Nowadays, political engagement has a strong impact on how the society treats persons with disabilities. Documents, action plans and programmes are vital in creating a decent environment for dignified life of persons with disabilities in Croatia and worldwide. However, it should be noted that many highly developed countries are still struggling to provide decent circumstances for persons with disabilities and adequately implement these political measures despite numerous documents protecting the rights of these people. The level of participation of people with disabilities in processes of political decision making was negatively evaluated by 89.8% of respondents, while no more than 10.2% expressed a positive attitude. Participation and inclusion in public debates is perceived as insufficient by 85.7% of respondents. Research results confirm the hypothesis on insufficient participation and inclusion of people with disabilities in the realm of public decision making. As previously stated, a vast majority of respondents are also dissatisfied with participation levels in the realm of employment (95.9%) (see Chart 2).



*Chart 2: Participation of persons with Disabilities in the Realms of Labour Market and Public and Political Decision Making (%)*

As much as 87.8% of respondents believe that the problem of employment can be tackled by ensuring additional funds from the state budget. It can be concluded that most interviewees are not satisfied with political decision making and/or implementation of changes in the Republic of Croatia; the emphasis should therefore be put on the need for further systematic work aimed at asserting and protecting the rights of persons with disabilities.

#### 4.3. Attitudes towards persons with disabilities: analysis of qualitative indicators

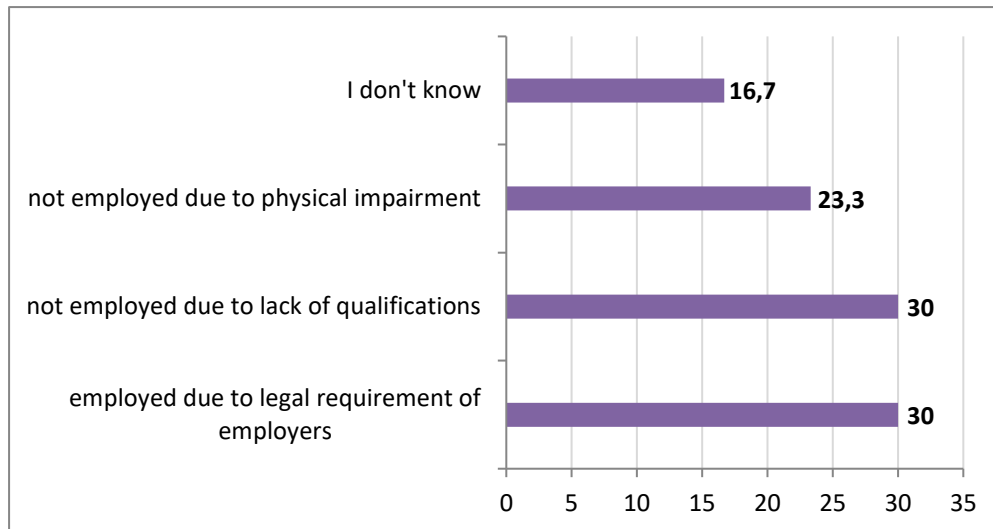
Within the questionnaire, respondents were asked several open-ended questions in order to gain more insight into certain obstacles and stereotypes that persons with disabilities encounter in everyday life and the labour market. In this sense, for full inclusion into community life, it is first necessary to ensure equal access to services, such as through the construction of business buildings that are fully adapted to the needs of persons with disabilities, securing of funds for the provision of physical aids and proper training of medical staff for medical care (Narodne novine, 2007, pp. 8-9). Respondents' answers have been quantified. The most common problems faced by persons with disabilities are stereotypes regarding their work efficiency, as pointed out by three quarters, i.e. almost 80% of respondents (see Table 1). The problem of architectural barriers is highlighted by 12% of respondents, whereas 6% emphasise the narrow range of jobs available, 2% the lack of qualifications and 2% the lack of understanding on the part of employers.

*Table 1: Main problems encountered by persons with disabilities in seeking employment (%)*

Main problems	%
Lack of understanding on the part of employers	2
Stereotypes on poor work efficiency	77,6
Architectural barriers	12,2
Narrow range of available jobs	6,2
Lack of qualifications	2
Total	100

Respondents propose a number of possible solutions to improve their status: 23.3% name increased social activity, 20% point to better communication with employers, 23.3% stress better professional support, 20% put focus on the increase of income, and 13.4% emphasise the need for a better legal framework. With regard to the new Act on Vocational Rehabilitation and Employment of Persons with Disabilities, 40.2% of respondents state not to have observed any actual implementation of the Act, 36% gave no answer, 13.3% believe that the Act was poorly prepared, 4.1% could not comment on the regulations, and only 6.1% of the respondents believe that the aforementioned Act benefits persons with disabilities. Also, 30% of respondents point out that the main reason for low employment of persons with disabilities is the lack of qualifications; 30% believe that people with disabilities are employed due to the law requiring employers to hire them; 23.3% said they are not employed due to their physical impairment, while 16.7% could not respond (see Chart 3).

*Figure following on the next page*



*Chart 3: Main factors of (non-)employment of persons with disabilities (%)*

In conclusion, the state needs to take all appropriate measures to eliminate discrimination on the basis of disability, which can also be achieved through the government's cooperation and partnership with non-governmental organisations. In this regard, 33.3% of respondents believe that the new Act will not be of any use unless associations of persons with disabilities become more involved in public decision-making. In assessing future circumstances based on past experiences, 26.7% of respondents estimate that new laws (if adopted) will not contribute to improving the position of people with disabilities. Only 16.7% of the respondents believe that such laws would be only partially useful, whereas 10% are not able to say. No more than 13.3% think that new laws will lead to any significant changes.

## 5. CONCLUSION

Work is a purposeful activity that involves physical and/or mental effort and possesses an economic and/or symbolic value. This definition covers more than salaries of employees and includes activities that generate economic value even if they are unpaid, such as caring for others and volunteering, which contribute to a sense of social value. The contemporary Western concept of work highlights its role in meeting income needs, but also in simultaneous psychological and social fulfilment, identity achievement and family support. At the same time, through work we contribute to the state and the community and serve others (Budd, 2013, pp. 985-987). Employment creates the conditions for existential independence, which is an important goal of every person. The disadvantaged position of persons with disabilities in the labour market leads to objective problems such as lower income, limited opportunities for lifelong learning, lower employability and social insecurity. Therefore, for persons with disabilities in particular, employment has an additional dimension. It represents social integration into society, helps to overcome the barriers that arise from society's stereotypes and prejudices, and strengthens the sense of work ability and social competence. This also reduces the common feeling of inferiority, which is intensified during unemployment, and promotes the achievement of actual (not just declarative) equality with other members of society (Majsec Sobota et al., 2006). The work of persons with disabilities brings many benefits for the society as a whole, but the biggest is certainly its economic value, as no country in the world is so rich to be able to forego the earnings (material contribution) brought in by the work of persons with disabilities. The goal of persons with disabilities is to become contributors to the state budget, and not just users of budget funds (Rački, 1997), which also greatly reduces other state benefits. Most respondents in our research believe that employers are still not familiar enough with the problems faced by persons with disabilities. Prejudices continue to play a significant role in creating the image of persons with disabilities

as employees. Also, a lack of qualifications is recognised as an equally important problem, along with existing stereotypes on their work efficiency, architectural barriers and a narrow range of jobs available. Almost half of the respondents were not familiar with the new Act on Vocational Rehabilitation and Employment of Persons with Disabilities, and as much as 96% had not been able to find a job more easily since its implementation. Most respondents find that persons with disabilities are not sufficiently involved in public decision-making. They also point to a number of possible solutions that could help improve their position, such as increased social activity, better communication with employers, professional support, and the increase of financial benefits/subsidies. The implementation of the new law on employment of persons with disabilities that has been adopted in the Republic of Croatia can affect the equalisation of employment and work opportunities of this group with the rest of the population. Therefore, the results of this and similar research additionally highlight the social importance of recruiting persons with disabilities, which can be a significant tool in affecting a change in employers' attitudes and relationship towards this group in the labour market. This research primarily aims to show that the quality of life of persons with disabilities is not just reflected in medical treatments, rehabilitation, and care, but also entails a complex process of satisfying a number of their socio-psychological needs, interests, choices and desires as full-fledged members of society.

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## THE FLAT TAX: THE HOLY GRAIL FOR THE FUTURE OF EUROPEAN’S TAXATION SYSTEMS?

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### ABSTRACT

*It is widely known that Western European countries’ tax systems are suffering from a deep crisis, being the current progressive taxation models no longer able to achieve their original goal, i.e. realize equality among taxpayers according to the theory of income’s decreasing marginal utility. Several economic studies show indeed that the personal income taxes currently in force in Europe no longer properly address the taxpayers’ ability to pay as only few incomes’ categories are actually subject to progressive taxation, meaning that the personal income taxes are no more shaped as “comprehensive” income taxes. Moreover, the development of these tax systems has led to very complex tax rules for the taxpayers to comply with – this characteristic, combined with high marginal tax rates often deemed confiscatory and with the lack of protection of the minimum of subsistence, has encouraged tax evasion phenomena. In order to address the before mentioned weaknesses of the progressive taxation systems, some proposed to turn to a flat taxation design. Being already adopted in more than 60 countries all around the world as of the Fifties, this model is awarded as the one able to solve most of the problems at stake, notably to remarkably simplify personal income taxation, enhance compliance, and – to certain extent – increase the tax yield. In this paper I’ll analyse pros and cons of the flat tax system, taking into account those countries which have already experienced the adoption of this model, with a particular focus on the current Italian political proposal to turn the progressive personal income tax rate structure to a flat one, combined with personal deductions to respect the principle of progressivity held at art. 53 It. Const.*

**Keywords:** *comparative tax law, flat tax, personal income taxation, progressivity*

### 1. INTRODUCTION

Every social organisation, from the simplest one (such as a small local community) to the most complex one (such as a country), needs financial resources in order to provide the required services to its components. These revenues are commonly gathered through taxation, i.e. the power of a public authority to impose and demand contributions upon citizens. Currently, personal income taxes are usually structured according to the principle of progressivity, meaning that incomes subject to personal taxation are taxed with graduated tax rates: the more an individual earns, the more he will be subject to the burden of taxation. In first instance, progressivity could appear to infringe the equality principle; anyway, as the Dutch school of taxation noticed, equality among taxpayers is recovered under the point of view of the equal “tax sacrifice” requested to them. Progressive taxation is indeed defended on the grounds that the marginal utility of additional layers of income and wealth constantly decreases (and, as a consequence, taxable capacity constantly increases), so that a larger proportion of tax may be taken from successive slides of income. Under this point of view, anything remained in an individual’s hands, after he has satisfied his primary needs, expresses a minor utility for him and could be subject to heavier taxation: according to this theory, private needs and subsequent consumption acts could display different marginal utilities, thus justifying the application of graduated rates. To this extent, progressive income taxes on individuals are considered an important achievement of the XX century. Nevertheless, the principle of progressivity and its applications are currently under attack – many scholars, tax experts and economists have indeed pointed out that the structure of personal income taxes is no longer able to let them achieve

their original goals: many incomes fall completely outside the scope of progressivity, being taxed with proportional withholding taxes; far too many countries apply excessively high graduated tax rates which discourage production; the theory of income's decreasing marginal utility should be revised, as income's concrete utility should be evaluated not only under an individual's perspective, but also under a social one (what if high income earners use part of their income for charity activities, to increase savings or for health matters?). New questions consequently arise: is graduated taxation still an actual topic? Could there be an alternative option to structure personal taxation? Could flat taxation be a valid instrument? I'll try to answer these questions in the next paragraphs, firstly taking into account progressive taxation and its evident weaknesses and then considering flat taxation's experiences.

## **2. WEAKNESSES OF THE PERSONAL INCOME TAXES CURRENTLY IN FORCE**

In most European and economically advanced countries personal income taxes currently in force have failed to realize horizontal equality among taxpayers. Despite their progressive structure, they have distortive effects for the reasons that will be further examined, and the general feeling is that they need to be re-thought.

### **2.1. The gradual erosion of progressivity's scope. Personal income taxes are no more “comprehensive” income taxes**

Worldwide, personal income taxes were meant to address the so-called “comprehensive income” of the taxpayers, to be determined as the sum of incomes falling within certain income tax categories defined by law – e.g. income from employment, self-employment, business, capital, land, etc. – and to be taxed at progressive tax rates. However, since their enactment personal income taxes underwent several amendments, which, over time, have substantially modified their original structure. Nowadays, indeed, personal income taxes do not address the taxpayers' “comprehensive income”, rather only incomes stemming from certain categories – namely, income from employment and self-employment. This is due to the fact that legislators have chosen to tax certain incomes, such as incomes from capital, with withholding taxes at proportional tax rates as well as to introduce many exemptions to progressive taxation. For instance, most of European Union's Member States provide for withholding taxes on dividends, interests and royalties, as a result falling these incomes completely outside the scope of progressive taxation. Moreover, the applied flat tax rates differ significantly from State to State: in Germany, capital income is subject to a flat tax of 25% plus a solidarity surcharge of 5,5%, both withheld at source; in Austria, interest income is subject to a withholding tax of 27,5%; in Belgium the applied withholding flat tax rate amounts to 30% (the same rate applied by Sweden), but there are reduced rates of 15% and 17% to be applied in certain restricted cases; in Hungary, capital gains and dividends are subject to a 15% withholding tax at source, whereas interest income stemming from investments held for at least 3 or 5 years is, respectively, not subject to tax at all and subject to a 10% flat tax rate. The gradual erosion of the scope of progressivity then continued, excluding from progressive taxation incomes from minor businesses, incomes from real estate as well as providing special tax regimes for a country's non-residents. As a consequence, next to personal income taxes addressing, by now, solely incomes from employment and self-employment, many tax microcosms have flourished. This process appears to be irreversible and unstoppable, so much so that other derogations are looming on the horizon. It is then clear that personal income taxes completely missed the goal of taxing the taxpayers' “comprehensive income” and that they are no more universal and general income taxes as they were meant to be. On the opposite, nowadays the burden of progressivity regards only incomes stemming from employment and self-employment: this unlucky feature has the effect of discriminating among taxpayers gaining the same amount of income from different sources, being taxed at progressive rates or with lower withholding taxes

irrespectively of the total sum earned. To this extent, personal income taxes have failed to realize horizontal equality among taxpayers.

## **2.2. Personal income taxes do not grant the protection of the minimum of subsistence**

Another relevant issue concerning the progressive income taxes currently in force is the lack of a uniform protection of the minimum of subsistence, i.e. a certain amount of income which, because it is destined for satisfying an individual's primary needs, is worth not to be taxed. The underlying idea is that taxation should not expropriate taxpayers' income, rather leave in their hands at least what's necessary to live a dignified life. For instance, in Italian tax law this concept is encapsulated in art. 53 It. Const., according to which “Each person shall contribute to the public expenditure in relation to this taxable capacity”: the formula “taxable capacity” has indeed been chosen in order to grant no taxation under a minimum threshold, namely the minimum of subsistence, this way recognising that not every economic capacity shows a capacity to contribute. Other constitutions, such as the Spanish one at article 31, don't refer to this subject matter directly, simply stating that progressive taxation couldn't go further than a certain level – unfortunately not specifying the threshold but leaving to a (hopefully wise) legislator this choice. On the opposite, in Germany there's no constitutional level provision granting no taxation for low incomes; anyway, the jurisprudence has developed certain parameters in order to (try to) achieve this goal. According to the German Supreme Court the quantification of the minimum of subsistence (so-called “Existenzminimum”) depends on general economic conditions and private needs (BVerGe, 25.09.1992); more recently it has stated that it should be proportionate to the economic resources needed to guarantee decent living conditions, taking into account not only the material and concrete dimension of the individual existence, but also social relations, political participation and cultural experiences (BVerGe, 9.02.2010). At first glance, one could be induced to think that the presence of constitutional provisions as well as the jurisprudence's evolution could be sufficient to exclude from taxation the minimum of subsistence. Unfortunately, this is not the case as legislators have shown far too little sensitivity when coming to concretely realize these principles. Indeed, even if the protection of the minimum of subsistence is sometimes recognised at a constitutional level and sometimes elaborated by the efforts of the jurisprudence, in fact it is not always concretely enacted and, even when tax laws provide for deductions in order to take into account the non-taxability of the minimum of subsistence, these measures are not universally guaranteed. For instance, in Italy the protection of the minimum of subsistence is enacted providing special deductions to taxpayers; unfortunately, only few taxpayers could claim this benefit as it is granted only with respect to very low-income earners and only in case the source of income is employment. Also in other countries the protection is very fragmented: in Austria certain allowances are available against taxable income only if income is lower than € 60.000; in Belgium the personal basic allowance amounts to € 7.500 if taxable income is lower than € 27.000, whereas for higher incomes it substantially decreases until zero; in Hungary the basic allowance depends on the number of dependent children; Ireland provides for a tax exemption for certain individuals aged 65 or more only in case their income is lower than € 18.000 (or € 36.000 for married couples); according to Dutch tax law, the tax exempted amount depends on the box to which belongs the earned income, having each category each own rules; etc. Absent general provisions concerning the protection of the minimum of subsistence applicable to all taxpayers, personal income taxes currently in force have failed to achieve this goal. As a result, again, even under this perspective the personal income taxes do not grant the respect of the principle of horizontal equality among taxpayers, as taxpayers gaining the same amount of income could be subject to different tax burdens – whereas, as a general principle, a personal deduction should be granted to everyone, irrespectively of the total income earned or the income's source.

### **2.3. Personal income taxes in an international perspective**

Last but not least, the structure of personal income taxes currently in force in most of European Western countries appears inadequate to properly address the challenges of an international taxation environment. Due to the burden of high marginal tax rates (often “confiscatory”), taxpayers feel encouraged transferring taxable incomes from high-tax countries to the so-called tax havens – and this could be quite effortless to realize, depending on the incomes’ nature (are they volatile? could they be easily hidden? could they be gained through a limited liability entity?). Taxpayers have also developed sophisticated ways to take advantage of tax loopholes and tax treaties’ provisions, locating – and taxing – incomes in the most favourable European (or extra European) tax regions. Countries are trying to fight against these misconducts; however, rather than implementing tons of different anti avoidance rules, countries should coordinate each own tax rules in order to best prevent these phenomena.

### **3. WHAT ABOUT INTRODUCING A FLAT TAX ON “COMPREHENSIVE” INCOME?**

When discussing about how to address the proven weaknesses of the progressive personal income taxes currently in force, some proposed to turn the progressive design to a flat one, meaning an income tax with a single tax rate, an exemption area and certain deductions for particular cases (namely, family members and inabilities). Worldwide, many States have switched to this model during the last decades – the earliest countries to adopt the flat taxation model have been the Jersey and Guernsey Islands, respectively in 1940 and 1950, followed by Hong Kong in 1960 – and many other States are evaluating benefits and risks of adopting a flat tax on personal incomes. The debate concerning the preferability of one model instead of the other one is not new; the proposal to tax personal incomes with a single – and relatively low – tax rate traces back to the last Century, when the first countries chose to implement the flat tax model and economists and experts started to study it. In the following paragraphs I’ll take into account the theoretical basis for flat taxation on personal incomes as well as whether the flat tax’s experiences have led to positive or negative results, in order to identify which could be the best tax policies for the future of national tax systems.

#### **3.1. The theories behind flat taxation**

The debate concerning the economical and juridical theorizations of flat taxation dates back to the precious contributions of two American economists, Hall and Rabushka, who belonged to the “supply-side economics” school of thoughts. The starting point of their analysis stressed the extreme complexity of the American income taxation system existing in the Eighties as well as the steep scale of graduated rates in force with respect to personal income taxation. These two factors combined, according to the feeling at that time, were held responsible for the fast-growing episodes of tax evasion and avoidance: taxpayers, indeed, showed clear preference for non-tax compliance conducts rather than exposing to the risk of committing mistakes and the excessively high progressive tax rates induced them to save as much as possible income from taxation. Moreover, according to their theory, that taxation system significantly hindered economic development and business activities – so, this obstacle needed to be removed. Under these premises, they proposed a personal taxation scheme based on a single tax rate, lower than the rates in force, accompanied by specific deductions for individuals and family members. The flat rate should apply on taxable income above a fixed exemption area and deductions should be allowed only for strictly defined situations and expenses. They indeed detected in a flat taxation system the best instrument to simplify the personal taxation system of that time as well as to enhance and promote development. According to their theorization, flat taxation is very simple to realize and, being so transparent, it is easy for the taxpayers to comply with, so that they would not have any more incentives to avoid income taxation.

Moreover, such a flat taxation would finally realize horizontal equality among taxpayers, treating identical situations the same way and granting the low incomes' exemption to everybody.

### **3.2. A flat tax's SWOT analysis**

According to this perspective, a flat tax system addressing the taxpayers' comprehensive income is usually considered as a sort of “holy grail” for both taxpayers and the public authority. The flat tax design is indeed regarded as potentially able to ensure multiple desired benefits: first of all, a simpler tax system thanks to a sole and low tax rate, which should consequently discourage tax evasion phenomena, being tax avoidance no more that convenient compared to the risk of being assessed by the Tax Authority. Put plainly, in a progressive tax system with high marginal rates taxpayers would seek to save their income from personal taxation, paying as less taxes as possible, or even no tax at all, leaving to the Tax Authority the burden of recovering the unpaid tax – if they would ever be assessed. Whereas, in a flat tax system the tax saving would not be that high and taxpayers would prefer to pay taxes rather than to be exposed to the risk of an assessment. This reasoning explains also why and how, with a flat tax on personal income, would still be possible for the State to gain the amount of financial resources needed for the public expenditure: in first instance, indeed, the tax yield would diminish because of the lower tax rates, but this “loss” would be recovered thanks to the fact that also taxpayers who previously didn't pay taxes would be encouraged to pay them because of the lower rate. Anyway, the recovering of the formerly unpaid taxes is an assumption of the flat tax's model, which could also not be verified in practice: this is the strongest Governments' fear in evaluating the implementation of a flat tax on personal incomes, because in the event that not sufficient resources were collected, the State should necessarily cut (a part of) the public expenditure, with possible disruptive effects on collectivity. Nevertheless, the hoped decrease of taxpayers' despised conducts (e.g. tax evasion, exploitation of loopholes, transferring of taxable income to low-tax countries...) would very likely make the Tax Administration's costs for the assessment's and tax recovering's procedures drop, freeing resources to be spent in other – more productive – ways.

### **3.3. Flat taxation's experiences between success and failure**

This being said on a theoretical basis, what's interesting is to examine the performances in economic terms of the States which have already introduced a flat tax on personal incomes, taking into account the effects on the tax yield's pattern and on the GDP's trend. To this extent, a successful experience is the Hungarian one. Hungary introduced a flat tax on personal incomes in 2011, substituting the previous double rates progressive system (17% and 32%) with a lower single tax rate of 16% combined with a family tax allowance granted to families with numerous children. This tax reform is particularly remarkable as Hungary is the only country whose flat tax faithfully reflects the Hall-Rabushka's theorization. After its enactment, in 2012 the tax yield increased significantly, recording a + 2% compared to 2011. This striking performance is due to an increase in the Vat collected: presumably, the lower tax burden on personal incomes has left taxpayers more money to spend in transactions subject to Vat. Another outstanding performance is the Romanian one; in 2005 Romania introduced a flat tax at a rate of 16% and subsequently recorded an increase in the tax yield straight connected to an increase in revenues from direct taxation. In the years after the tax reform, tax revenues improved of + 5,3% and 6,5%, compared to the GDP. Outside Europe, the most important successful experience is the Russian one. Russia turned to a flat tax on personal incomes in 2001, at a rate of 13%. In 2002, tax revenues from the personal income tax increased of + 46% compared to the previous year and, in the period 2001-2008, the Russian GDP constantly increased at a medium annual rate of + 6%.

Nevertheless, some economists remarked that this striking performance is not fully creditable to the flat tax's adoption, rather also to other collateral tax reforms enacted in those years, among which the extension of the Tax Administration powers'. To this extent, the tax revenues' increase could be explained by both the favourable low tax rate and the taxpayers' feeling of potentially being easily assessed. On the opposite, the adoption of a flat taxation on personal incomes has also had not such positive effects for some other countries: I refer specifically to Bulgaria and Slovakia. In 2008, Bulgaria turned from a progressive personal tax system with two tax rates of 20% and 24% to a flat tax system with a single tax rate of 10%. The Government thought that such a low tax rate would have promoted tax compliance, reducing tax evasion phenomena. Anyway, things went slightly differently, as tax revenues never increased – but anyway, the flat tax rate was very low if compared to the lowest graduated tax rate previously in force and this dramatic reductions has been a clear hazard. The Slovakian picture is even more discouraging. In 2004, Slovakia introduced a flat tax on personal incomes at a rate of 19%; the result of this reform has been a marked decrease of proceeds: in 2004, tax revenues from personal taxation amounted to 31,5% of GDP, in 2012 to 28%. The Slovakian financial situation was so dramatic that in 2013 the flat tax was abolished and progressive tax rates were reintroduced.

#### **4. THE ITALIAN'S FLAT TAX PROPOSAL**

Like most of the countries currently adopting a progressive personal tax on incomes, even the Italian personal income tax, called Irpef, is suffering from a deep crisis. Despite the appearances, the graduated Irpef is far from being a personal and general tax on comprehensive income: rather, it uniquely addresses incomes stemming from employment and self-employment, remaining incomes from other sources taxed with withholding taxes at different proportional tax rates. Indeed, income from capital – principally, dividends and interests – is subject to withholding tax at source (the tax rates vary, depending on both the subjects distributing and receiving dividends); income from real estate is taxed according to its cadastral value, widely underestimated; incomes from new business activities are taxed at lower proportional rates, etc. Moreover, Irpef is regarded as to be a “double-distortive” tax: on one side, there's no uniform protection of the minimum of subsistence as only very few taxpayers are entitled to claim this deduction; on the other side, progressive tax rates increase very fast – for instance, taxable incomes until € 28.000 are taxed at 27% and incomes until € 55.000 at 38%. In this panorama it's no surprising that many supporters of the flat tax design started claiming a change in the personal taxation structure. Anyway, the uprising transition process has walked quite slowly. In 2003, the Parliament delegated to the Government an important task, this representing the first step towards the possible introduction of a flat tax on personal incomes: the idea was to reduce the five tax rates to only two (lower) tax rates and, at the same time, widen the taxable base. However, this tax reform has never seen the light essentially because of the common concern of not being able to collect a sufficient amount of resources needed for the public expenditure. Moreover, some claimed such a tax reform would have been unconstitutional as article 53 It. Const. provides for “a taxation system base on progression criteria” and a flat tax on personal incomes could violate this constitutional principle. This reasoning is, however, incomplete and superficial. Indeed, the constitutional norm simply asks for the system to be progressive, whereas does not require progressivity to be realised applying graduated rates. This aim – i.e. a progressive system – could be achieved also by a flat tax on personal incomes combined with specific personal deductions: this way there would be no increasing marginal tax rates but the average tax rates would still increase in parallel with earned incomes. In June 2015, a political party submitted a legislative proposal in order to introduce a flat tax on personal incomes with a single tax rate of 15% and a personal deduction amounting at € 3.000, which would have still achieved system's progressivity.

While this proposal is still under evaluation, during the last political elections also other political parties made similar proposals, which differ from the one at stake under the point of view of the tax rate and the minimum exempted from tax. Even tax experts and economists issued flat taxation projects, suggesting the implementation of a single rate of tax around 20% and an exempted area of € 5.000. These proposals, even if still not completed in all their details, have been positively judged by Italians, considered that the political parties that submitted these ideas have collected the majority of the votes at the last political elections. The direction taken by Italy is clear: a tax reform is needed and a simplification towards a model of flat taxation seems the best option. Anyway, still some points remain obscure and need to be clarified – namely, how to financially sustain the initial decrease in the amount of taxes collected during the first years of implementation of the flat tax and which is the optimal level of the tax rate as well as of the tax exemption. These issues are currently at stake and it will be up to the upcoming Government to explain how to deal with them.

## 5. CONCLUSIVE REMARKS

Is then flat taxation a reasonable and credible alternative to progressive taxation, likely to be able to solve (most of) the issues at stake? The choice between a flat taxation model instead of a progressive taxation one depends on complex evaluations and countries should take into account each own tax policy's aims. With particular regard to horizontal equality among taxpayers, it's paramount that personal income taxes characterized by graduated tax rates have completely failed to reach this goal. To this extent, the flat design of a personal income tax addressing the taxpayers' comprehensive income – so including also income currently “escaping” progressive taxation – would assure horizontal equality. Moreover, guaranteeing to all taxpayers a fixed personal tax exemption would assure the respect of the minimum of subsistence and a low proportional tax rate would make tax evasion and tax avoidance phenomena no more that convenient. Likewise, it's also clear that Governments should start to discuss in order to establish the proper level of a flat tax rate and of the minimum exemption as well as to identify the proper ways to face with the initial decrease in the tax yield, which should not be underestimated. In case countries are willing to maintain the same level of tax revenues, the flat tax should be designed with a relevant tax exempted area and a medium tax rate – this is the only “recipe” to grant a graduated tax collection and an unchanged tax yield. In this case, low-income earners as well as high-income earners would benefit the most from the new tax structure, whereas mid income earners would be penalised. In order for all taxpayers to take advantage of a flat taxation design, the flat tax's parameters should be fixed without the limit of equal revenues. Whichever will be the choice, in my opinion, the substitution of the current progressive tax system with a flat rate taxation should necessarily be accompanied by other collateral tax reforms: the Russian's experience is valuable on this point, and clearly teaches us that the flat tax itself could not be sufficient to drastically change the current tax crisis.

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## AMICABLE RESOLUTION OF FAMILY DISPUTES

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### ABSTRACT

*Resolving of family disputes, especially those including children, requires adaptable and less traumatic procedures. The most significant such mechanism in the Republic of Croatia is family mediation, but some other methods of amicable resolution of family disputes have a significant role. Family mediation as a mechanism of amicable resolution of family relationships considers not only divorce disputes and those disputes that are to be resolved with the divorce, but especially the disputes connected with exercising the right to parental care, personal relationship with the child, as well as all pecuniary and non-pecuniary disputes which are connected with the family relationships. In this paper, the author provides an overview of the legal framework of all models of peaceful resolution of family disputes in the positive Croatian legislation, with the special highlight on family mediation. That overview favours the efforts of the Croatian society encouraging and developing the institution of amicable resolution of family disputes and it thus contributes to modern and regulated society based on mutual respect and tolerance.*

**Keywords:** *amicable resolution of disputes, family mediation, family relationship*

### 1. INTRODUCTION

Family mediation implies a method of alternative dispute resolution based on negotiation and facilitation of communication between the family members. In the practice of resolving the conflicting family disputes in European countries, mediation is emphasised and encouraged as an exceptionally important method of family dispute resolution, especially those involving children (Recommendation No. R (98) 1 of the Committee of Ministers to Member States on Family Mediation, [http://www.coe.int/t/dghl/standardsetting/family/7th%20conference-enfiles/Rec\(98\)1%20E.pdf](http://www.coe.int/t/dghl/standardsetting/family/7th%20conference-enfiles/Rec(98)1%20E.pdf) 30 April 2018). The underlying reason is that divorce is a rather traumatic experience for children because it introduces substantial changes into their lives that they have no influence over, and which usually greatly affect their emotional development. During the process of resolving the conflicted interests of the parents, it is of the utmost importance to preserve constructive relationships between the parties for the purpose of promoting and protecting the family under newly developed circumstances, especially with the aim to protect the minors. Hence, mediation through a third party tends to prevent or at least reduce the damaging consequences of the parental conflict, especially in terms of the children-parent relationship and the mutual relationship between the parents, as these relationships are characterised by indivisible emotions and permanence. The Republic of Croatia follows the trend of the European countries which encourage and develop mediation as one of the methods of amicable resolution of conflicted family relationships through the facilitation of the negotiation process for the persons and situations in conflicts which require assistance in order to identify their underlying problems and achieve a reasonable and acceptable mutual understanding.

### 2. DEVELOPMENT OF AMICABLE RESOLUTION OF FAMILY DISPUTES IN THE REPUBLIC OF CROATIA

Amicable resolution of family disputes in the legal system of the Republic of Croatia existed in the Basic Act on Marriage of 1946 (Official Gazette of the Socialist Federal Republic of Yugoslavia, No.: 29/1946, 36/1948, 44/51, 18/55, 4/57, Official Gazette of the Social Federal

Republic of Yugoslavia, No. 28/65-consolidated text) which was later superseded by the Civil Procedure Act of 1956 which derogated the provisions on conciliatory hearing and further elaborated the institution of mediation. Conciliation or mediation procedure was also previously conducted before or after divorce proceedings; the purpose of conciliation in divorce proceedings essentially regarded the reconciliation of spouses and the preservation of the institution of marriage, which was achieved by determining the underlying causes which led to the conflict between the spouses and the disruption of their marital relationship. In the conciliation procedure, the spouses were also introduced with the legal repercussions of the dissolution of marriage. Substantial changes regarding conciliation occurred upon entering into force of the Act on Marriage and Familial Relations of 1978 (Official Gazette of the Socialist Republic of Croatia, No. 11/78, 27/78 – correction, 45/89, 51/89 – consolidated text and 59/90, hereinafter: AMFR). This Act transferred the conciliation procedure from the competence of the court into the competence of the then entity for social care, present-day Social Care Centre. The purpose of the conciliation of spouses was to interrogate the parties on the underlying causes which resulted in the disruption of their marital relations, and to attempt to remove such causes, if possible, and to reconcile the spouses (Article 63 para. 1 of AMFR). In addition to said purpose, the conciliation of spouses intended to encourage the spouses to agree on the issue of custody when the attempt to reconcile the spouses and preserve their marriage has failed. In the implementation of AMFR, conciliation only referred to divorce proceedings, regardless if the spouses had minor children of their own or adopted children or children with extended parental care. The Family Act of 1998 (Official Gazette, No. 162/98, hereinafter: FamA/98) replaced the earlier conciliation of spouses with the pre-divorce mediation procedure (Articles 44-51 of FamA), with certain modifications, the most important one being that the pre-divorce mediation procedure was prescribed as a procedural requirement for the institution of the divorce proceedings exclusively if the spouses had minor children, their own or adopted, or children with extended parental care (Article 44 para. 1 of FamA/98). It has been noted in the legal literature that during that period the main purpose of the institution of mediation was “clearly associated with the attempt to provide better care for the children after the dissolution of marriage of their parents.” (Aras Kramar, S., taken from Alinčić, M.). According to the Family Act of 2003 (Official Gazette, No. 116/03, 17/04, 136/04, 107/07, 57/11, 61/11, 25/13, 75/14, 5/15 and 103/15, hereinafter: FamA/03) the mediation procedure was always conducted if the divorce proceeding were initiated by filing a claim. The purpose of pre-divorce mediation according to FamA/03 was to preserve the marriage. This derives from the provision of Article 48 para. 1 according to which the mediator, usually the Social Care Centre, was obligated to interrogate the parties on the underlying causes which had led to the disruption of their marital relations, and tend to remove the causes and reconcile the spouses, and the provisions of Article 48 para 2 according to which the mediator was obligated to introduce the spouses with the legal and psychosocial repercussions of their divorce. However, the pre-divorce mediation did not introduce the spouses, who were also the parents of minor children, with their rights and obligations regarding minor children nor did it encourage them to reach an agreement on certain aspects of parental care. Mediation as a method of resolving family disputes was first introduced in the family legislation of the Republic of Croatia by the Family Act of 2014 (Official Gazette, No. 175/14, hereinafter: FamA/14) applied from 1 September 2014 to 12 January 2015 when the Constitutional Court of the Republic of Croatia issued a Decision on the institution of the procedure for the assessment of harmonisation of the Family Act of 2014 with the Constitution (Decision of the Constitutional court of the Republic of Croatia U-I-3101/14 of 12 January 2015 – Official Gazette, No. 5/15). In the same decision, the Constitution Court issued an interim measure which suspended the application of the entire FamA/14 until the delivery of the final decision in the process of constitutional control, and it adjudicated the application of FamA/03. Thus, until the delivery of the Family Act of 2015 (Official Gazette, No. 103/15, hereinafter:

FamA/15), familiar relations were regulated by an ineffective regulation which was nevertheless applied, whereas they were not regulated by the regulation in force. FamA/15 regulated the issue of family mediation in a similar way as FamA/14.

### **3. CHARACTERISTICS OF FAMILY MEDIATION IN THE REPUBLIC OF CROATIA ACCORDING TO FAMA/15**

The amicable resolution of family disputes is one of the fundamental principles of FamA/15 because the provision of Article 9 of this regulation obligates all entities which provide professional assistance or decide on family relations to encourage amicable resolution of family disputes. In addition to said fundamental principle, the familial legal tradition in the Republic of Croatia is founded on the principles of voluntariness, confidentiality and impartiality of the family mediator. The principle of voluntariness derives from Article 320 para. 2 of FamA/15 and implies the freedom of the parties to decide on initiating the mediation procedure, because it is a procedure in which the family members willingly participate. The obligation of the parties to participate in the mediation procedure is prescribed by FamA/15 only for the first meeting of family mediation if the spouses, who decided to divorce, failed to agree on joint custody before or during compulsory counselling. In that case they are obligated to attend the first meeting if family mediation before the initiation of the divorce proceedings (Article 54 para. 3 and Article 320 para. 3 of FamA/15). Non-compliance with this obligation results in the inadmissibility of the filed divorce claim, and it only refers to the spouse who intends to file a divorce claim (Article 54. para. 4. FamA/15). In conformity with the provision of Article 335 of FamA/15 and Article 7 para. 1 of the Ordinance on Family Mediation (Official Gazette, No. 103/15), family mediation is also based on the principle of confidentiality which is in line with the Recommendation of the Council of Europe on family mediation whereby the discussions within the mediation procedures are confidential and cannot be subsequently used, unless the parties stipulate otherwise or in cases where the exceptions are defined by the national legislation. The duty of the family mediator and other participants in the family mediation procedure is to safeguard confidential information and data (Article 335 para. 1 of FamA/15), and to inform the parties about the scope of the principle of confidentiality (Article 335 para. 2 of FamA/15). An exception to the obligation to safeguard confidential information and data is provided by Article 335 para. 1 of FamA/15, namely: if the disclosure of information is necessary for the implementation of enforcement of the agreement or if the disclosure of information is necessary for the protection of a child whose well-being is threatened or for the removal of risk of a serious psychological or physical harm to the person's identity. On the other hand, according to said Ordinance on family mediation which is also based on the principle of confidentiality, the confidentiality of the content of family mediation shall be exempt only in the event of a serious threat and life-threatening circumstances of the family members whereby the Ordinance on family mediation specifies the cases for the exemption from the principle of confidentiality. The principle of impartiality of the family mediator implies that the mediator should be capable of treating all parties in the mediation procedure equally and providing them with equal opportunities during the procedure. The mediator is deemed impartial if s/he shows no particular bias towards any of the parties in the procedure, provides them with equal timeframe and level of attention, and equally supports each of them. Furthermore, in relation to Article 340 of FamA/15, the family mediator who conducted the procedure of family mediation is not allowed to participate in the preparation of the expert opinion, family assessment or in any other way participate in the court proceedings concerning the dispute between the parties who participate in family mediation. FamA/15, unlike FamA/14, is not based on the principle of neutrality whose notion is somewhat different from the notion of impartiality. The mediator may have a personal viewpoint and values opposite from the conflicted parties or in conformity with any of the conflicted parties, however s/he is not

allowed to verbalise them. If the conflicted parties urge the mediator to express the personal viewpoint, s/he may express a personal viewpoint, advice or suggestion, but only if such viewpoint, advice or suggestion does not side with any of the parties. The provision of new information, for instance legal information, or proposal to attend family counselling should be expressed by retaining impartiality (Sladović Franc, B., *Obilježja obiteljske medijacije*, 2005, p. 5).

#### **4. SPECIFICITY OF FAMILY MEDIATION ACCORDING TO FAMA/15**

The specificity of family mediation according to FamA/15 is that it can be conducted regardless of the stage of the court proceedings: before, during or after the court proceedings (Article 334 para. 1 of FamA/15). Family mediation is not conducted before the initiation of the enforcement and insurance proceedings, because it is prohibited by the provision of Article 334 para. 2 of FamA/15, except in the case of enforcement animated at the achievement of personal relationship between a parent and a child, when the court may propose family mediation to the parties even during the enforcement proceedings (Article 334 para. 3 in relation to Article 522 para. 2 of FamA/15). The provision of Article 332 para. 1 of FamA/15 provides for the cases in which family mediation is not conducted: (1) if, according to the assessment of the expert team of the Social Care Centre or family mediator, equal participation of both spouses in the mediation process is not possible due to domestic violence, (2) if one or both spouses are deprived of legal capacity, and thus unable to comprehend the meaning and legal repercussions of the procedure despite professional assistance; (3) if one or both spouses are deprived of sound reasoning, and (4) if the domicile or residence of a spouse is unknown. Mediation concerning divorce proceedings is the most common form of family mediation, but the notion of family mediation is significantly broader than the notion of divorce-related mediation, since it refers to all conflicted relations in the family (Article 332 para. 2 of FamA/15). The aim of family mediation is to successfully terminate said proceedings by reaching an agreement on joint custody or another agreement in conformity with Article 336 of FamA/15. The agreement on joint custody, according to the provision of Article 106 para. 1 of FamA, is a written agreement between the parents concerning the plan to realise joint custody under the circumstances when the parents do not permanently reside in the same family union. The provisions of Article 106 paras. 2 and 3 of FamA prescribe compulsory and optional content of the joint custody agreement, whereas the Ordinance on the prescribed content of the form of the joint custody agreement (Official Gazette, No. 123/159) contains the form of the joint custody agreement. FamA/15 prescribes the form of the joint custody agreement and other agreements reached in the procedure of family mediation by defining the written form and signature of all parties in the procedure pursuant to the provision of Article 336 para. 2. In conformity with para. 3 thereof, the joint custody agreement and other agreements reached in the procedure of family mediation has the capacity of an enforcement deed if the court, in accordance with Article 336 para. 3 of FamA/15, if the court approves it in the extrajudicial proceedings upon the parties' proposal. The family mediation procedure may be terminated by suspension in conformity with FamA/15 and the Ordinance on family mediation. The completion of the family mediation procedure according to FamA/15 is not related to the deadline within which a joint custody agreement or other agreement should be stipulated. The Ordinance on family mediation, however, limits the number of meetings held during the mediation procedure in the social care system to the minimum of two up to the maximum of five meetings over the course of several weeks, usually in two-week, sometimes even more frequent, intervals. In terms of the participants in the family mediation procedure, they are as follows: family mediator, parties in family mediation, both from marital and extramarital unions, children and other family members depending on the type of family dispute related to mediation. In the Republic of Croatia, the family mediator, in conformity with the provision of Article 331 para. 2 of

FamA/15, should be an impartial and adequately trained person entered in the Registry of family mediators, which is published on the website of the ministry competent for social care affairs in relation to the provision of Article 10 para. 2 of the Ordinance on family mediation. The requirements for the entry in the Registry of family mediators is the postgraduate university specialists study of family mediation (Article 2 para. 3 of the Ordinance on family mediation). The Registry of family mediators is managed by the ministry competent for social care affairs in conformity with Article 341 para. 1 of FamA/15. In terms of the agreement terminating the family mediation procedure, FamA/15 provides for the agreements on child support and alimony in the provision of Article 302 of FamA/2015, while the provisions of Article 433 item 4 and Articles 470-473 regulate a special extrajudicial proceeding for the approval of the financial support agreement.

## **5. PARTICIPATION OF CHILDREN IN THE PROCESS OF FAMILY MEDIATION**

The purpose of participation of children in the procedures which concern them primarily focusses on the protection of the best interest of the child and the acknowledgement of his/her rights, but also the protection of the best interest of the family and the preservation of quality of the family life, especially in terms of the relationship between the parents and the child, and other familial relations, in particular if family life routine alters due to inter-familial conflicts. The possibilities and the ways a child may participate in the family mediation procedure depend on the parents' agreement and the evaluation and assessment of the family mediator on the adequacy of that type of participation. The right of a child to participate in the procedures which concerns him/her is based on the provisions of numerous international legal acts, in particular the Convention on the Rights of the Child (Official Gazette of the of the Socialist Federal Republic of Yugoslavia, No. 15/90 and Official Gazette – International treaties 12/93 and 20/97). Numerous non-binding acts of the Council of Europe, which are nevertheless extremely important, also concern the right of a child to participate in the procedures which concern him/her, including the family mediation. One such act is the Recommendation of the Assembly of the Council of Europe 1639 (2003) on family mediation and gender equality (<http://assembly.coe.int/nw/xml/XRef/Xref-XML2HTML-en.asp?fileid=17171&lang=en>). Said Recommendation amends the fundamental underlying principles of the Recommendation on family mediation of 1998 (<https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=09000016804ecb6e>) and defines the participation of children in the concerned family mediation procedure with special emphasis on the need to hear the child as a special subject and holder of rights in the dispute between the child's parents (item 6). Another related document refers to the Guidelines for a better implementation of the existing recommendations concerning family mediation and mediation in civil matters (<https://rm.coe.int/16807475b6>) focussing on the undertaking of adequate measures to raise the public awareness on the benefits of mediation. According to the provisions of FamA/15, family mediation may be conducted within and outside the social care system. When the procedure is conducted within the social care system, the participants should be introduced with the Recommendation of the Council of Europe on the children's rights and social services friendly to children and families of 2011 (<https://rm.coe.int/168046ccea>) which emphasises the need to make sure that the social services hear the child's view and give it due consideration. In addition, the Recommendation of the Committee of Ministers of the Council of Europe concerning the participation of children and young people under the age of 18 2012 (<https://rm.coe.int/168046c478>) emphasises the right of a child to be heard and be given due consideration (detailed information on children's rights in family mediation can be found in: Čulo Margaletić, A.: Prava djeteta u obiteljskoj medijaciji, 2017, <https://hrcak.srce.hr/191578>). However, said documents do not prescribe the manner in which the children's rights to the freedom of expression should be realised in family mediation, even though they emphasise and

guarantee such rights. FamA/15 prescribes the obligation of the parents to introduce the child with the content of the joint custody agreement and enable the child to express his/her opinion in relation to his/her age and maturity, and to comply with said agreement in line with the child's best interest (Article 106 para. 4). Unlike the case where there is a dispute between the parents and parents and children, FamA/15 does not provide for the possibility to appoint a special guardian for the child in the family mediation procedure who would enable the child to express his/her opinion, nor does it provide for the possibility that a child expresses his/her opinion through other expert professionals.

## 6. CONCLUSION

Mediation has been recognised in international relations through numerous legal acts as an important and indispensable model of amicable resolution of family disputes upon the legal dissolution of the family union, because it contributes to the protection of the best interest of the family, and especially minors, in new, often, traumatic circumstances. This is probably because mediation encourages civil and cooperative dialogue between the family members even after the parties reach the agreement on the termination of the mediation procedure. By introducing FamA/15, which is the fundamental regulation for regulating family relations, the Republic of Croatia has demonstrated that it follows the European trends of encouraging and developing mediation as one of the most effective alternative models for resolving family disputes, especially those involving children. Encouragement and development of the methods for the amicable resolution of family disputes is extremely important for the development of a modern and tolerant society based on acknowledging mutual differences. National and international acts regulating family mediation as a model of amicable resolution of family disputes indicate the importance of including children into the decision-making process on the issues which concern them, but fail to ensure the mechanism which would enable the children to express their opinion in the mediation procedure. Hence, the provision of these mechanisms should be an attainable challenge at the national and international level, so as to ensure that the mediation results in the best interest of children within the conflicting family relations.

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## MONEY LAUNDERING PHENOMENOLOGY

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### **ABSTRACT**

*Money laundering is a financial operation that involves converting money earned into performing criminal activities in regular cash flows. Money gained in criminal activities becomes legal. Criminal activities happen in one state, and money laundering in the other, so this treatment gets the character of an international criminal act that makes it difficult for investigators. Practice says that money laundering can take place in one country, but this is rarely happens. Money laundering prevents the normal functioning of the national and international economies, but also disrupts the social stability of the countries in which it is taking place.*

**Keywords:** *Money laundering, crime, economy*

### **1. INTRODUCTION**

The term money laundering was coined in the famous 1920s gangster era of American history (Sullivan, 2015). Between gambling, prostitution, and sales of prohibition alcohol, there was a lot of cash that required laundering. In other words, a method or methods had to be developed so that the government did not become suspicious about the true nature of a gangster's funds. The major headache that gangsters faced was that the money they “earned” was in the form of cash currency—and often in small-denomination bills or coins. If the funds were put into the bank, then questions would be asked by the bank and ultimately the government. Further, storing large amounts of money in low-value coins is a physical and logistic nightmare. So, the gangsters created businesses, one of which involved slot machines and another of which was laundromats. The coins could be used to “gamble” and to “wash clothes”. Of course, the number of coins actually used far exceeded the true amount gambled or used at the laundromat, and it was made to appear that more gambling or more clothes were washed than actually were. And so, it is said, the term money laundry was born. By treating money and corruption, which is a frequent accompanying phenomenon, creates a dangerous threat to sovereignty, the authority of state power, undermines democratic values and public institutions, and greatly damages the national economy (Bejaković, 1997). These jobs are encouraged by traditional forms of tax evasion, law abolition, smuggling, and the escape of financial resources, which together increases the tax burden on taxpayers. Money laundering directly affects the reduction of transparency and the distortion of financial market health, important determinants in the effective functioning of the entire economy. The money earned from criminal activity usually corrupts financial market officials, causing long-lasting and difficult repair damage to market credibility. Money laundering can corrupt parts of the financial system and disable the successful management of central banks and supervisory bodies. If a bank executives become corrupt, non-market behavior can be extended to other areas that are not directly related to money laundering, thus endangering the bank's security and creditworthiness. People who supervise the work of a bank may also be corrupt or intimidated by threats, which reduces, and sometimes completely disables the effectiveness of supervision. It is therefore necessary to strengthen the legal provisions against money laundering, but this does not mean reducing the traditional banking control.

### **2. MONEY LAUNDERING**

New information technology, flexibility and adaptability, professional help and the enormous financial resources available make it much easier for the money laundering process and its

transfer across borders (Bejaković, 1997). Although banks are increasingly involved in money laundering, there are no other institutions where larger amounts of cash are used and often not under stronger legal regulation or control, such as savings banks, casinos, exchange offices and insurance companies. Also, there have been cases of money laundering by purchasing gold and precious stones, art objects, antique furniture and the like, which all require constant adjustment and vigilance of the competent authorities. It should not be neglected the constant inflow of new resources from criminal activities, and the introduction of crime into new areas of action. Organized international crime behaves like transnational companies: more and more, it enters into strategic co-operation, increasing its ability to circumvent the law, reducing competition and reducing the risk of being caught in legal offenses and enabling different profits to be gained in different markets. As in the legal economy and organized crime, entrepreneurship is appreciated, and the ultimate goal of doing business in both sectors is to earn more profits. The threat to the money laundering for society is also a consolidation of the economic power of organized crime, as it allows it to enter the legal economy. The concept of money laundering through properties covers a complex international activity involving placement, layering, shell companies, wire transfers, and unfamiliarity (De Sanctis, 2017). Everything we have seen emphasizes the complexity, sophistication, international element, and glamour of laundering. We have seen several ways in which property purchases are made with money from crime but are dealt with in such a way to conceal the criminal origins been acquired otherwise than by crime (i.e., the use of cash and informal money transfer systems, money transfer between jurisdictions, and the use of corporate anonymity through attorney-client privilege and banking confidentiality to restrict availability of information). Even more than the confiscation of the proceeds of crime, money laundering has been the subject of sustained interest among police officers, prosecutors, politicians and academics alike (Stessens, 2003). The explanation for this remarkable interest should be sought in the socio-economic consequences of this phenomenon. Money laundering is rightly considered as a derivative from predicate (often organised) crime activities and as such it is able to spread the detrimental consequences of these criminal activities to many parts of society. The impetuses for attempting to tackle money laundering operations are numerous, but they all have in common that they view money laundering not as a reprehensible activity in itself, but as part of a larger criminal activity which is harmful to society. The infiltration of dirty money is a crucial problem from national economies (Cindori, 2007). The purchase of shares, of real estate, the establishment of dirty investment funds and the use of the banking system for the embedding of such resources is a danger to the credibility of a whole country, and in particular to the security of the financial and banking system. Croatia has adopted statutory measures aimed at the effective detection and prevention of suspicious financial transactions, in other words the prevention of money laundering. Launderers constantly find new ways, make use of new non-financial channels and expand their activities to real estate, artworks and insurance. Hence it is necessary to keep up with European approaches and recommendations, to strive for further improvement of the laws and the modernisation of the system, and to adopt new regulations harmonised with international standards.

### **3. MONEY LAUNDERING PHASES**

The money laundering process is mainly conducted in three phases:

- an investment phase in which money is made directly out of a criminal activity (such as sales of drugs) is invested for the first time either in a financial institution or in the purchase of a certain assets;
- a concealment phase in which attempts are made to conceal or seem to change the real origin or resources owner;



- the integration phase in which the money is involved in the legal economy and the financial system and accruing to other values in the system.

Some money laundering phases can be concurrent or they can be overlapping (Bejaković, 1997). As the particular phase will take place, and what methods will be used depending on the available washing mechanisms and the organized crime claim that the job is commissioning. In any case, money laundering involves many different techniques that are usually complex, ingenious and secretive. It is common for them to hide their original origin and ownership of money, and that the clients want to keep control of the procedure itself and, if necessary, to make that change.

#### **4. ORGANIZED CRIME AND WHITE-COLLAR CRIME**

To create laws to effectively combat organized crime on national and international levels, it is necessary to have a mutually accepted definition that distinguishes organized crime from other forms of criminality (Roth, 2010). The lack of consensus has hindered international law enforcement for generations. Indeed, for more than a century, academics, journalists, government officials, and criminal justices have debated the meaning of “organized crime.” Attempts at arriving at a definition can seem like “tilting at windmills,” as no definition can simultaneously address present and future forms of criminality. A prominent theory of white-collar crime holds that organizations have distinctive cultures which are more or less tolerant of law violation for the benefit of the firm (Apel, 2009) This explanation purports to account for why college-educated, relatively affluent, and seemingly conventional persons can commit crime when they are employed in white-collar occupations. The vexing paradox of “why good people do dirty work” can be resolved by positing that some organizations turn a blind eye to ethical and legal infractions if it benefits the firm, thereby creating a culture of rule breaking which is learned just as any other business practice is learned. Another theoretical view posits that firms with a tolerant view toward business ethics may attract people with “loose” ethics, which itself leads to corporate and white-collar offending. The second view harmonizes with the notion of “assortative mating”—that people are attracted to those environments with which they are more compatible by disposition. The difference between these two views is not trivial. One posits that the ethical climate of an industry or firm has a causal impact on the occurrence of white-collar crime; the other is compatible with the view that the relationship between culture and crime is spurious. Using as a case study research within another criminological tradition—the relationship between youth employment and delinquency—we argue that disentangling causation from selection should be a research priority for the study of white-collar crime.

#### **5. MONEY LAUNDERING AND WHITE-COLLAR CRIME**

The closing decades of the twentieth century saw dramatic change in the way policy makers and elite academics talk about crime and what should be done about it (Shover, 2006) In place of the deterministic accounts of its sources that had enjoyed support for decades, they turned to and advanced an interpretation of crime as choice. Seen in this way, aggregate-level crime rates are determined by the supply of opportunities for crime and the number of individuals willing to exploit them. As to the further problem of explaining why only some do so, crime-as-choice theory resurrects an answer advanced by philosophers nearly two centuries ago: they choose. As with all choices, criminal ones are said to be preceded by a decision-making process in which individuals assess options and their potential net payoffs, paying attention particularly to potential aversive consequences. The possibility of arrest and punishment presumably is prominent among these. When viewed through the lens of crime-as-choice theory, crime unambiguously is purposeful and calculated action. The most economically disadvantaged members of society are not the only ones committing crime (Gottschalk, 2014).

Members of the privileged socio-economic class are also engaged in criminal behavior. The types of crimes these people commit may differ from those of criminals of lower classes. Some examples of crimes committed by members of the upper classes include business executives bribing public officials to get contracts, chief accountants manipulating balance sheets to avoid taxes, and procurement managers approving fake invoices for personal gain. Criminal behavior that involves financial crime by members of the privileged socioeconomic class is labeled white-collar crime. It is often argued that women commit fewer white-collar crimes when compared to men. Suggested reasons for possible gender differences in the commission of white-collar crime include risk aversion and lack of opportunity. Gottschalk defines a white-collar crime like this (Gottschalk, 2015): Nonviolent crime for financial gain committed by means of deception by persons whose occupational status is entrepreneurial, professional or semi-professional and utilizing their special occupational skills and opportunities; also, nonviolent crime for financial gain utilizing deception and committed by anyone having special technical and professional knowledge of business and government, irrespective the person's occupation.

## **6. MONEY LAUNDERING IN THE CROATIAN CRIMINAL CODE**

The criminal act of Money laundering in the Croatian Criminal Code (Kazneni Zakon) is contained in Head XXIV. entitled "Criminal Offenses against the Economy", described in Article 265.

Money laundering, Article 265:

1. Whoever invests, assumes, transfigures, transfers or exchanges the proceeds of the criminal act in order to conceal its unlawful origin, shall be punished by imprisonment for a term between six months and five years.
2. The punishment referred to in paragraph 1 of this Article shall be punished by anyone who disguises the true nature, origin, place, disposition, transfer, and the existence of the right, or ownership of the proceeds of the proceeds of the criminal act.
3. The penalty referred to in paragraph 1 of this Article shall be punished by any person who has acquired the proceeds of crime, gains, possesses or benefits.
4. Whoever commits a criminal act referred to in paragraph 1 or 2 of this Article in financial or other business or the perpetrator is engaged in money laundering or the property gain referred to in paragraphs 1, 2 or 3 of this Article is of high value, shall be punished by imprisonment for one to eight years.
5. Whoever takes the action referred to in paragraphs 1, 2 or 4 of this Article by acting in negligence with regard to the circumstance that the proceeds of the proceeds are criminal acts, shall be punished by imprisonment to three years.
6. If the property gain referred to in paragraphs 1 to 5 of this Article is committed by a criminal act committed in a foreign country, the offender shall be punished if it is a criminal act and under the law of the State in which it was committed.
7. The perpetrator referred to in paragraphs 1 to 5 of this Article who voluntarily contributes to the disclosure of a criminal act by which the property gain was realized, the court can release the perpetrator from the punishment.

The money laundering procedure refers to the concealment of the true source of money, ie, object or money laundering right that is known to have been obtained through a criminal act (Pavisić et al., 2007). The content of the action refers to banking, monetary or other economic activity. It should be emphasized here that the incrimination in question was conceptually created as an incrimination for various criminal justice systems between economically connected states.

This implies a different approach with emphasis on solidarity and co-operation in combating crimes, while retaining the fundamental principles of criminal responsibility. The market economy assumes such an approach.

## **7. CRIMINALISTICS ASPECTS OF MONEY LAUNDERING**

Many of the operations have common elements or characteristics that make them more easily identifiable as money laundering schemes (Madinger, 2012). The simpler schemes are also building blocks for the more complex operations. The most convoluted, detailed scam in history can still be broken down into its component parts. The concept of components is a good one. Money laundering schemes are a lot like computer systems, made with many individual parts and pieces, all designed to work together to process information. The most complicated money laundering schemes in history are ones that the organizers loaded up with all sorts of fancy component elements, like Swiss bank accounts, letters of credit, shell corporations, nominees, or front businesses. Just looking at the big picture, we've got little chance of unraveling such a rat's nest, but if we isolate these components, addressing them as separate parts of the whole system, we may be able to reduce the problem to a manageable size. Inquests of criminal offenses in cases of suspicion of money laundering are extremely demanding and specific, and are activities that need to be integrated into regular investigations of criminal acts of economic crime, corruption, organized crime and drug crime, or all investigations of criminal acts by which a large property gain (Paviscic, 2012). Therefore, in order to detect and prove the criminal act of money laundering, police officers must simultaneously with predicate criminal acts conduct financial investigations, which means inquests related to the detection of money laundering offenses. When a suspicion of the commission of a criminal offense resulting in unlawful material gain is found, a series of checks must be undertaken to determine the perpetrator's property status and the detection of financial transactions for the purposes of determining and finding illegally acquired property, namely the disclosure and proof of the criminal act of money laundering. Such checks are necessary in all cases where there is a suspicion that certain criminal acts create illegal property gains and verifications to determine the resulting property gain, the amount of that benefit, where it is located, the formal owner, so that it could be suggested to the court a temporary and permanent deprivation of such of illegally acquired funds.

## **8. CONCLUSION**

Money laundering is a financial operation in which illegal money is converted into legal. In this way, the perpetrated criminal offense is concealed and the unlawful material benefit acquired is used, and is used as legal income in business investments. Under concealment are activities that the other side of the business needs to make sure it is legal, not unlawfully acquired money. The content of criminal justice incrimination is related to financial affairs performed by legal or natural persons or active participants in the market of goods and services. There are two forms of perpetration. The first is based on the perception that money has been obtained by committing a criminal offense and that money laundering is undertaken to concealment that circumstance. The second form is to obtain unlawful material gain. Money laundering is an operation that is mostly conducted at an international level and therefore, in the criminal justice sense, it should be considered as an international criminal act. Such circumstances is difficult for investigators, but relevant international institutions are ready to respond to it. A number of international documents and regulations of national legislation enable a successful fight against this type of crime.

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## NEW COAT FOR LABOUR LAW?

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### ABSTRACT

*It is widely accepted that the legal framework of labour law has been changed, which resulted many new challenges. This phenomenon created by the developing labour market cannot be handled by the traditional ways of legislation. This process has been fastening and becoming more and more complex, thus, the forthcoming tasks cannot be foreseen yet. On the other hand, it can be stated, that despite the changing economical environment, the goals and targets of labour law are persistent. Unfortunately, the recent attempts (e.g. the idea of flexicurity) were not able to divert the unwanted processes, so there is still challenge to find the ideal solution. This, we think, cannot be a command and control type legislative action, but a multi-layered complex and coherent system, in which the already achieved results of the multinational companies (e.g. International Framework Agreements) will embody a new platform of protection. To stimulate the above mentioned developing area of labour law, the state has to create some kind of relation to this process, in which a complex legal framework should be established. In this new legal environment the classical approach of law (command and control) should be overshadowed by the principle of transparency and the voluntarily co-operation. The greatest issue in this project is to find the proper tools with which the original purpose of the above mentioned legal institutes can be upheld, but legal guarantee can be presented at the same time. With this method, the classical hard law frames of labour law could be covered with a band new “soft law coat”, which could result a new level of protection of the worker’s rights.*

**Keywords:** labour law, CSR, regulation methods, hard law, soft law

### 1. INTRODUCTION

Zygmunt Bauman condensed into two words the essence of globalisation: speed, and infinity in geophysical sense. Accordingly, the colourful and globalised world of work sees again and again unforeseeable and dynamically developing creative cross-border phenomena, which the labour law must or should be ready to handle. Nowadays, the question is not about whether labour law is needed to be renewed and whether a new concept or new regulatory means are needed to be introduced in labour law, but about how labour law should approach this dynamically developing labour market, what values should it protect and what kind of instruments should be used as protection. We need to realise that, in addition to the rules and instruments that are founded on our lawyer thinking which is based on the original commanding-controlling-enforcing by law method, a change of perspective and a broader dimension are needed so that we do not simply anticipate that the goals can be achieved only through enforcing written laws but, taking all chances, we take advantage of the possibility that voluntary consumer or corporate actions or, indirectly, certain institutions of other fields of law

may have a beneficial effect on labour law values. We may be, and we are indeed sceptical towards these effects, and we may argue about how much and to what extent these effects are useful, whose interests they serve, but we should do so while taking advantage of them. The first part of the essay explains why labour law regulation needs renewal, namely it shows the changes the object of labour has seen in the previous decades. The second part of the essay shows that simultaneously with the aforementioned phenomena corporations and primarily larger corporations introduced a social responsibility approach which resulted in strategies and institution that are capable of promoting the assertion of employees' rights. The third part points out that, in this world facing the crisis of labour law, it is advisable to exploit all opportunities that support employees' rights, especially the benefits of institutions originating from social responsibility. However, we should provide credibility to these institutions by including them under the scope of legal regulations, taking these legal institutions from corporate self-regulation to the scope of legal regulations. For it to be successful the regulatory instruments are required to be broadened and regulatory tools that are based on reflective legal grounds are added to the “command and control” type labour law rules. Consequently, new elements are added to the traditional regulatory instruments of labour law which in this way gets a “new coat”, thus includes new phenomena under its protection, and its traditional goal, namely to reduce the dependence of employees, is strengthened.

## **2. THE REASONS AND SYMPTOMS OF TRADITIONAL LABOUR LAW REGULATIONS**

### **2.1. The criteria or traditional employment relationship**

Labour law is in a crisis; this trivialised thought has been written again and again in the legal literature of the previous 20 to 30 years. It is in crisis for the traditional legal relationship based on an employment contract is no more the only and general form for performing work, and for this reason the regulations that are based on it are no longer capable of achieving its objectives, which is the protection of the weaker party, the party performing the work. The concept and regulation that “are fit for the economy of a certain industrial society” is in crisis, and the “reform attempts” seem to be inconclusive. Traditional labour law regulation presumes that employment relationship is the only context in which work can be performed. Employment relationships are the results of agreements between employers and employees and are based on employment contracts. However, having regard to the inequity between the parties, in particular the vulnerable and dependent position of employees, the legal relationship could not remain the subject of free negotiations, and it was required to introduce mandatory rules in this legal relationship that is basically of contractual nature. The traditional paradigm of labour law is based on the “Ford” model, according to which the employer is an integrated and undivided entity with a clear central management, engaged in productive activity that is similar to an atom and has clear boundaries. The employee, being the other party to the legal relationship is a man employed by the employer in full-time for an indefinite period, and they both are supposed to intend to establish a long-term legal relationship. This allows the employee to ensure the well-being of his family as the sole maintainer. In traditional employment relationships, the place of work is permanent, is located in an area that can be geographically defined, mostly areas of large factories, where the employee fulfils his tasks using the employer's equipment, subject to the employer's instructions, and the decisions related to the management of work is taken by the employer in the interest of increasing its own profit and at its own risk.

### **2.2. Economic and social changes that lead to the crisis of traditional labour law**

The economic and social conditions surrounding labour law have been changed by the beginning of the 21<sup>st</sup> century, and the Ford model on which traditional labour law rules are based, even if still exists, can no longer be considered as typical, and accordingly, the efficiency

of the rules that are based on this primarily standardised model have been challenged. The explosive technological development, the growth of services' sector, the increased vocational qualifications and strengthening professional autonomy of employees as well as globalisation created opportunities and expectations to which a certain part of employers and employees have adapted quickly or involuntarily, but adapted. The dominant position of “man-manual-factory production was occupied by the “multi-coloured-digital-third sector”. The process resulted in the changes of elements related to the subjects of certain employment relationships, having essential effects on their contents. The employer's identity has changed. The role of employers has got structured and networked and its unity has been divided upon the establishment of multi-level governance and management models in which the characteristics of employers and employees have merged. The composition of employees has changed. Due to the shortage of work force following the world wars the employment of women workforce arose, and its spreading caused that the family model of the 21<sup>st</sup> century is no longer based on the breadwinner man, but it is the entirety of the goods created by the man and woman workforce. As the existence of woman workforce became accepted, employment relationships faced new conflicts being challenges in terms of regulations and for employers, too. The place of work has geographically spread. Due to the fast development of information communication technology tools, the place of work is often has no relevance, and tasks that require cooperation for the purpose of attaining the same objective can be fulfilled effectively by employees who stay in different continents. It allowed that teleworking forms and the performance of outsourced tasks were spread in diverse forms. Labour law has become complex. Labour law is no longer regulated on a national level, national legislations are influenced by international binding norms and international norms containing recommendations.

### **3. NEW WAYS AND METHODS SERVING TRADITIONAL PURPOSE**

The role of labour law regulations could be precisely defined in the traditional Ford model: the purpose of labour law was to protect the economically dependent party that is the employee by adopting rules that mitigate the differences pertaining to the positions of employees and employers for the purpose of brining the parties in balance, and by ensuring the enforcement of these rules. It means that the original purpose of labour law is to balance social and economic inequities in employment relationships. This purpose remains permanent and should be ensured in the future irrespective of any changes. The question is merely whether new ways and means should be used in a time when the criteria of employment relationship are unstable. It is therefore worthy of widening our perspective and discovering, beyond the rights enforced by the law, those market phenomena the objectives of which are identical to that of labour law regulations, thus which are capable of balancing the primarily social and economic inequities in employment relationships. This essay seeks to point out that the markets, primarily alongside corporate social responsibility, have seen strategies, legal practices, institutions which all guarantee the implementation of labour rights, primarily social rights, at a level higher than provided by the law. Here we mean institutions adopted in the context of corporate social responsibility as a background ideology, such as commitments included in CSR codes, IFAs (international framework agreements) and corporate strategies. In all of these, the employers voluntarily undertake to guarantee to their employees the implementation of rights set out in the laws and international conventions, and more than that, they all include additional commitments. These commitments are voluntarily, and their purpose may not be primarily to represent labour law values, still one of their effects is the “protection” of employees' rights. Many regard these commitments to be empty promises which cannot be enforced and verified, and thus are not capable of providing real legal protection. The question as to whether the legal institutions created by CSR can be relied on is justified. If they can be relied on, why and to what extent can they be relied on, and if they cannot be relied on, what can we do to make these



additional commitments by employers more credible. The next part of this essay seeks to address this question.

### **3.1. The force and effects of the CSR**

Those forming business life in the '70s shared the thoughts of Nobel laureate professor Milton Friedman who stated that corporations are responsible only for increasing profit. This approach reflected the fundamental conflict of interests that existed between employee and employer at that time and according to which the primary goal of employers is to maximise profits while of employees is to maximise earnings, which entail this conflict. Notwithstanding, we can at times go beyond the approach that capitalism is exploitative as the world, and the role and significance of business, as well as, due to the power of global capitalism to shape the society, social expectations towards the business world have changed. Corporations are nowadays actors in a complex network which have the potential to have dominant influence on the lives of those belonging to wide ranges of the population, regarding those alive now and future generations. Society expects from corporations to produce their goods in a way other than solely by exploiting the workforce of employees living in slavery to maximise profits, and corporations, decision-makers and consumers all have a role to play in ensuring the implementation of the fundamental human rights of employees, even if they have to pay its price. Therefore, avoiding such conflicts has become a fundamental company interest. This led to the appearance of those organised, standardised and publicly announced employers' conducts which have resulted in, either directly or indirectly, employees holding extensive entitlements, in excess of the minimum level laid down in the laws, aiming at increasing the employees' satisfaction and attachment. We are not saying that employers are generally philanthropists. On the contrary. We think that it all is based on the understating that the performance of a satisfied and well-qualified employee contributes to the economic success of the employer and spread its good reputation. This behaviour and strategy constitutes corporate social responsibility. Its primary objective is not the representation of labour law values, however, one of its effects is the “protection” of employees' rights. It is motivated by the employers' recognising that taking their social role seriously may result in competitive advantages, namely performance improves, their services become known, their good reputation strengthen, they are more attractive to the workforce, the performance of employees can be improved and fluctuation can be reduced. Corporate social responsibility has numerous names and faces; it means donation and also strategic tool that support corporate competitiveness. Numerous definitions and concepts are used, but as corporate social responsibility is still in the early stage of becoming a discipline in itself, clear and generally accepted theoretical foundations, which could serve as basis for an integrated definition, have not yet been laid, and it cannot be distinguished clearly from other fields such as strategic management, strategic communication and organisation theory. Definitions used in the literature put the emphasis on different elements of the concept. According to one of the definitions, the CSR means that the values and interests of stakeholders are incorporated in business operations. Pursuant to this definition, the corporate social responsibility is an efficient management activity by the stakeholders aiming at ensuring, by including those concerned and incorporating their interests, that the corporation complies with the so-called triple performance criteria to the fullest extent. Pursuant to the triple performance criteria approach, the corporation must seek not only economic efficiency, as social and environmental usefulness are also required besides financial success. The 3Ps that is the principle of people, planet and profit requires the success of financial, human and environmental resources. According to the definition set by the European Commission, corporations voluntarily implement social and environmental considerations in their economic activities and in their partner relationships in the framework of social responsibility. Under ISO 26000, social responsibility is the commitment of an organisation for its decisions and activities



having influence on society and environment, through transparent and ethical conducts, which contribute to sustainable development, including social welfare and health, take the interest of stakeholders into account, comply with the laws and international standards of behaviour, appears in an integrated manner in all fields of the organisation and is enforced through the corporate's relationships of the corporation. For the CSR to be included in politics, it is need to be recognised that the boundaries of corporations exceed the fences due to the influence their activities have on the lives of all stakeholders, be it the consumers, shareholders, employees or those in the supply chain, and vica versa. What reasons may drive a corporation to operate in accordance with the idea of social responsibility? Upon analysing his own experience and the results of other empirical researches, Niklas Egels-Zanden came to the conclusion that there are four circumstance that may inspire a corporation to organise its activity in line with the CSR. On the one hand, the CSR may be capable of promoting the good reputation of the corporation, strengthening client's confidence in the corporation and of serving the brand. Given that society is tending to view the operation of corporations from the perspective of their ethical and socially responsible conducts and the decision as to whether to use the services of the corporate are made on the basis of these aforementioned aspects, the CSR can serve as a tool for profit increase. Moreover, there is growing demand for such aspect not only on the part of consumers and NGOs, but also of shareholders and financial investors. On the other hand, the CSR may help to avoid certain state interventions as voluntary commitments provide for the legal protection of employees, without it being enforced though state actions. A further advantage can be the growing competitiveness of corporations engaged in the CSR compared to those which do not attach much significance to the CSR in their activities. The fourth reason of motivation is based on ethical reasons pertaining to the CSR. In making corporate decisions not only the perspective of increasing profits may be considered, but these decisions may be based on other commitments of value. The management and shareholders undertake commitments that do not primarily serve their economic interests for ethical reasons.

### **3.2. The criticism of CSR**

The policy and benefits of social responsibility is widely known nowadays; however, besides those supporting it, there are many others who express serious doubts about this phenomenon. Criticism is based primarily on four thoughts saying that the CSR policy is nothing more than a PR tool; it is an issue of concern only to large corporations, and it cannot even be traced in their outsourced activities, and it only helps operators having dominant position in the market to achieve undue social influence. According to the first doubt, the CSR is nothing more than a PR tool, a mere communication strategy with the aim of promoting the good reputation of the corporation, and is capable of enhancing the image of the corporation even in the case of a modest level of commitments. This doubt is not unjustified; but emphasising the role of stakeholders can be an answer. Should the performance be regarded as only for show, the stakeholders have the power to confront corporations with their original commitments and the objectives achieved in the context of social responsibility, and to take action, either with the power of the public or through boycotts. According to the next criticism, the CSR is not a general practice applied in the whole economy, but a conduct by large corporations, and it is not used by small-and medium sized enterprises. As for now, the CSR policy lies with the multinational corporations, but corporations, legislators and international organisation all have important roles in establishing the practice of CSR and spreading it. For example, there are numerous initiatives in the European Union seeking to raise awareness of the principles and practices of social responsibility at the level small-and medium sized enterprises. Large corporations can also promote their CSR policies, primarily to the members of their supply chain, extending their own principles to them and expecting them, in the form of mere demands or contractual obligations, to comply with those principle.

The third criticism relates to the former thought complaining that large corporations not only fail to promote their CSR policies to their supply chains, but, even though they operate responsibly, they actually outsource their irresponsible practices to their suppliers and partners. It is what responsible supply chain management seeks to avoid, and it may provide some reassurance to this undeniably real doubts. According to the fourth group of reservations, the responsible operations of corporations may result in their achieving undue influence on society's life, using such influence to carry out unethical and irresponsibly practices. We all experience the influence multinational corporations have on our lives, regardless of them being engaged in CSR policies or not. It is not possible to avoid such influences in the 21<sup>st</sup> century, all members of society, either directly or indirectly, are affected. They have significant political roles due to their influence and lobbying powers, and they are forming social circumstances in the interest of achieving their objectives. At the same time, they are in possession of all the material and human resources, operational and organisational culture that make them the most important driving force of innovations. If so, the existence of CSR policy is a commitment to social values; and the social benefits that may be achieved through operations established alongside the interests and values of the stakeholders outweigh the risks posed by them. This essay does not seek to justify the arguments pro and contra CSR. We believe that it is possible to take advantage of the CSR with due precautions, and we consider the institutions established through the CSR as additional means with which the legal protection of employees based on the laws can be supplemented. In order to render these legal institutions credible, it is advisable to subject them to some kind of light and flexible state regulation. The next part of this essay is engaged in presenting as to how to do that.

### **3.3. The dimensions of regulation and self-regulation, no law - soft law - hard law**

The legal institutions that came into existence along CSR background ideologies are primarily the products of corporate self-regulation, which, on the one hand, have certain potentials, but we must be aware of the risks of this for the show policy, that is that corporations use those as part of their brands and for advertisement purposes; for this it is necessary to establish assurances ensuring the credibility of these institutions. In this way, the state, acting in its legislating power, must intervene in the process. When intervening, the state faces the questions as to how to take advantage of the given institution while establishing its guarantees and contributing efficiently to its development: should it remain in the framework of self-regulation or should it be, to a lesser or greater extent, deprived of its self-regulating nature and be regulated. There are more ways for the state to handle self-regulation. It may have no intention at all to intervene in the process of self-regulation, remaining solely a beneficiary of the possible results. Therefore, the rules are adopted by the corporations that establish a set of norms with no binding force, without sanctions, and which produce effects upon their integration in the corporate culture. When the state intervenes in the process in any manner, the self-regulating tool is deprived of its self-regulation nature and becomes a regulatory tool with self-regulation roots. There are many options available in terms of regulation, and, I wish to explain two of them on the basis of the binding force of the laws that are adopted as the result of regulations. One of the cases when the regulations is incorporated in mandatory norms, hard law rules, adopted by the state. In this case, the state, upon its own choice of value and without regard to the will of the stakeholders, decides to provide for mandatory rules of conduct the implementation of which is ensured by means under public authority. The coherence of the commanding-controlling-sanctioning system is ensured by material and procedural rules for the purpose of achieving the objectives having been set. As there are different levels of binding force, another solution of regulation can be when the state does not render a conduct mandatory, but provides for the possibility of carrying out such conducts by creating their procedural frameworks, promoting their application without rendering them mandatory and without

imposing sanctions for the lack of their application. The Hungarian and EU regulations on enforcing sustainability aspects in public procurement procedures are examples for it. Although not setting forth the enforcement of environmental aspects in public procurement procedures, both the EU directive and the Hungarian Act on public procurement provide for the possibility to enforce such aspects. The contracting authority thus, through applying the assessment criteria or specific contractual conditions, is entitled to choose the tender that is the most advantageous in terms of environment protection or to stipulate environmental terms in the contracts. This type of regulation can succeed if the value choices supported by the state and the values of stakeholders coincide. Incorporating the values into the culture of stakeholders, thus without directly regulating the conducts of the stakeholders but through only influencing them, may be an indirect way to achieve the objectives of legislation. This set of rules is of a procedural nature and requires significant cooperation. The source of law originating from this type of regulation may be called soft law norm but this designation must be used carefully. The reason for caution relates to the fact that nowadays soft law lacks a general definition that could be interpreted uniformly, therefore it is advisable to determine what we mean by soft law. In the European Union, the concept of soft law often used for legal acts issued under names other than those specified in the founding treaties. The norms that are not found in traditional sources of law but set out clear rules of conduct thus are similar to laws are called soft law as well. I use the concept of soft law in a third meaning and I consider it to be a norm that is found in a traditional source of law but is a general, permissive and conditional norm therefore cannot be enforced and sanctioned. Labour law regulation in Hungary is based on hard law norms, on the command and control scheme. This was capable of ensuring the implementation of the purpose of labour law for a long time. However, this regulation technique in itself may be insufficient in this world changed by globalisation. Labour law regulations are in great need of becoming up-to-date and of the application of new techniques. This essay wishes to highlight that the state, if intending to regulate the legal institutions of corporate social responsibility and thus taking advantage of and ensuring its benefits, needs to broaden the regulation methods of labour law. It may be required to create flexible, framework-like set of norms consisting of procedural rules, which builds on the self-regulating mechanisms of large corporations and aims at incorporating in the corporate culture. When regulating the business policy of large corporations, it is essential to recognise that large corporations are rather driven by market mechanisms than by the pressure to comply with the law. In this spirit, the regulation to be established may be of reflexive legal nature with the aim to catalyse the mechanisms that have been established by corporate self-regulation, providing only “signal lights”. The theory of reflexive law originates from Günther Teubner who put the emphasis on the efficiency of a process-oriented regulation policy that supports the self-regulation of the private sector instead of on a top-down legal regulation setting forth specific rules of conduct. In the reflexive legal thinking, the society can be deemed an “autopoietic communication system” in which the legal entities are continuously engaged in interaction with each other and internal set of rules are formed upon mutual controls. The responsibility of the state is to establish counter-balance, assisting the self-regulation of subsystems by providing framework-like procedural rules. The concept of reflexive law thus, upon the consideration that economic actors view legal norms and compliance with them in the light of economic rationale, prefers a regulation technique which relies on the internal mechanisms of private sector actors, therefore rigid rules does not necessarily serve the objectives envisaged by the lawmaker. Instead of demonising large corporations, they should be encouraged to include and enforce social perspectives in their business policies. The self-regulation processes having positive impacts on employees should be supported. The law, by setting only objectives and frameworks instead of setting forth specific rules of conduct, facilitates legal entities to choose their own way while compelling them to continuously review with a critical eye, follow and improve the environmental impacts of their activity.

Reflexive law recognises the diversity of labour law issues and acknowledges that there are many ways to address them and therefore is not determined to choose one right way but rather wishes to support and supplement a self-regulation that has its focus on the objectives.

#### 4. CONCLUSION

The colourful and globalised world of work sees again and again unforeseeable, dynamically developing and cross-border creative phenomena, and labour law must or should be ready to handle them. For this not only the contractual structure but also the regulation methods should be made up-to-date. The market, in particular large corporations, has numerous employers' conducts or legal institutions that are established upon self-regulation, placing the implementation of employees' rights at the centre, such as CSR codes, IFAs, and sustainability reports. The lawmaker must approach these phenomena in some way in order to ensure that these conducts are tools available to employees can actually be enforced and do not merely serve marketing purposes. However, it cannot be achieved through the traditional command and control type of regulations. Therefore, the regulatory methodology of labour law needs to improve: there may be a need for soft law norms based on reflexive legal concepts, which catalyse the spread of these legal institutions and at the same time, establish its guarantees as well.

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## **IMPLEMENTATION OF DIRECTIVE 2013/11/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF 21 MAY 2013. ON ALTERNATIVE DISPUTE RESOLUTION FOR CONSUMER DISPUTES AND THE EXPERIENCES OF THE COURT OF HONOUR OF CROATIAN CHAMBER OF TRADES AND CRAFTS BEFORE AND AFTER IMPLEMENTATION**

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### **ABSTRACT**

*In this paper, the authors present experiences of the Court of Honour of the Croatian Chamber of Trades and Crafts as one of the 8 consumer alternative dispute resolution bodies in Croatia that have been notified by the European Commission after implementation of 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) into Croatian legislation by passing the 2016 Consumer Alternative Dispute Resolution Act. The authors start by providing an overview of the procedure before the Court of Honour in the period between 2000, when the Court was established, and the most recent developments of adapting its rules and practice to the new legislation in 2017. The authors also describe how the Court was continuously adapting to EU policies and legislation on consumer alternative dispute resolution over the course of its practice, and how it built trust and gained recognition among consumers and traders as an independent, transparent and efficient dispute resolution body. Furthermore, the changes that were necessary to make after the Consumer Alternative Dispute Resolution Act was passed in 2016 are described, as well as the impact that those changes made on the Court's practice. The authors proceed by analyzing benefits of consumer alternative dispute resolution before the Court of Honour of Croatian Chamber of Trades and Crafts and proposing possible solutions to questions that remain open. In conclusion, the authors put forward the opinion on how positive experience of nearly 20 years of the Court's practice in consumer alternative dispute resolution can be utilized to increase efficiency of this procedure in certain types of disputes in regular courts.*

**Keywords:** *alternative dispute resolution, ADR, consumer alternative dispute resolution, Court of Honour, Croatian Chamber of Trades and Crafts, Directive 2013/11/EU, Directive on consumer ADR, notified ADR body*

### **1. INTRODUCTION**

After Directive 2013/11/EU (CADR Directive), which establishes basic, EU-wide rules for Consumer Alternative Dispute Resolution<sup>1</sup> (Consumer ADR or CADR) was passed, these procedures gained significant visibility in all Member States. With this paper, the authors wish to increase the visibility of the Court of Honor of the Croatian Chamber of Trades and Crafts

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<sup>1</sup> „...any ‘alternative dispute resolution’ mechanism, that is, any mechanism that is ‘alternative’ to the traditional model of civil proceedings issued in the courts. (Hodges, Benöhr, Banda, 2012, p. xxix) The acronym CADR refers to alternative dispute resolution for consumers.

(CCTC) as one of the oldest national CADR bodies, notified by the European Commission in 2017 as a qualified body for resolving domestic and cross-border, *online* and *offline* consumer disputes and registered at the ODR Platform for resolving consumer disputes<sup>2</sup>, along with other qualified european bodies. History of the Court dates back to the so-called „Obranički sud“, a disciplinary body established in 1924, which resolved disputes related to trade, industry and crafts.<sup>3</sup> In recent history, its beginnings lie a whole decade prior the first Croatian Consumer Protection Act (CPA) in 2003 and two decades before the 2013 CADR Directive. The first Crafts Act from 1993 already stipulated that a craft *ex lege* ceases to exist if the Court of Honor brings the decision on cessation of trading. The same Act also stipulates the establishment of the Court itself (Art. 62) as one of the tasks of Croatian Chamber of Trades and Crafts. The Court's authority was then, among others, determining breaches (Art. 71) of good business practice, which are, for the most part, related precisely to breaches of consumer rights. Croatian Chamber of Trades and Crafts (CCTC), as an association that brings together natural persons engaged in economic activity (craftsmen) in a non-industrial way, has had its Renewal Assembly in 1994, three years after Croatia gained independence in 1991. In accordance with the Crafts Act (Art. 63), all the Chamber bodies were established, and for conducting procedures before the Court of Honor, a joint Court was established with the Croatian Chamber of Economy, where the CCTC had its own representative. The joint Court was active until 2000. In 2000, the process of establishing the independent Court of Honor of the Croatian Chamber of Trades and Crafts was set in motion. This process was finished with the adoption of the 2001 Crafts Act and the first Rules of the Court of Honor of the CCTC in 2002.

## **2. OVERVIEW OF THE PROCEDURE BEFORE THE COURT OF HONOR OF THE CROATIAN CHAMBER OF TRADES AND CRAFTS FROM 2000 TO 2017**

### **2.1. Jurisdiction of the Court of Honor**

The Court of Honor of the Croatian Chamber of Trades and Crafts, together with the Court of Honor at the Croatian Chamber of Economy, has become one of the five national authorities for CADR (along with three mediation centers) with the 2007 Consumer Protection Act. With co-financing from the state budget, the Courts continued to deal with almost all disputes in the procedures which consumers in Croatia initiate before CADR bodies whose jurisdiction is determined by law (Consumer Protection Act, OG 79/07). The jurisdiction of the Courts of the two Chambers is determined by the affiliation of a trader to a particular Chamber. Thus, for all consumer disputes where the craftsman (as a natural person carrying out an economic activity, a member of Croatian Chamber of Trades and Crafts) is a reported party, the Court of Honor of the Croatian Chamber of Trades and Crafts was competent and for those consumer disputes in which the trader was registered as a company (legal person, member of the Croatian Chamber of Economy) the Court of Honor at the Croatian Chamber of Economy was competent, according to its Rules. The aforementioned jurisdiction remains valid. Since there were no limitations, not then and not now, in relation to the professional or sectoral affiliation of a trader, these two Courts had all types of consumers disputes "covered".

### **2.2. Statute of the Croatian Chamber of Trades and Crafts (1994)**

Before the first Rules of the Court of Honor were adopted as an independent legal act, procedure before the Court was being conducted in accordance with the provisions of the Statute of the Croatian Chamber of Trades and Crafts, adopted in 1994. It's important to note that, during this time, the Court already operated in two instances: in the first-instance Council of three and in the second-instance Council of five judges. The main difference, compared to the procedure that we have today, was that the procedure was conducted on the action of the Chamber's

<sup>2</sup> <https://ec.europa.eu/consumers/odr/main/?event=main.home.show>

<sup>3</sup> Data retrieved from the records of National Archive Information System on the Chamber of Commerce in Zagreb

Prosecutor, and only exceptionally on the action of the injured party<sup>4</sup> Presidents of the first and second-instance Councils were mainly judges of regular courts, university law professors and other experts. For craftsmen to be appointed as members of the Councils, the main requirement was, as it is still today, a good business reputation. During this period, the Civil Procedure Code was also applied adequately in the procedure (Art. 65B p. 1 of the 1998 Statute). Wide geographic coverage was ensured with the provision (Art. 65C, p. 2 of the 1998 Statute) that the hearings can be held outside of the Court's Zagreb headquarters. The requirements for the reputation and expertise of the members of the Court bodies were clearly expressed and included legal education and bar examination for the President of the second-instance Council and the Executive Secretary.

### **2.3. Statute of the Croatian Chamber of Trades and Crafts (1999) and the First Rules of the Court (2002)**

An important turning point for the Court's procedure came with the adoption of the new Statute in 1999, abandoning the institute of the Chamber's Prosecutor and with it the application of the Criminal Procedure Act. Independence of the Court was explicitly emphasized (Art. 92, p. 2), and the principle of confidentiality of the proceedings was introduced by stipulating that the hearings in the Court are closed for the public (Art. 100) and that the members of the Court, as well as all its employees are obliged to keep confidential all personal and business information about the parties in the proceedings even after they stop working at the Court. Members of the Court pledge to make the decisions objectively and neutrally (Art. 100). As the most important novelty that the new Statute brought about, the authors would like to highlight the provision of Art. 99, paragraph 1, which obliges the Court to try, before imposing a measure, to resolve the dispute amicably, by reaching a settlement among the parties. The significance of the settlement was further enhanced by the provision of Section 2 of the same Article, which stipulates that the settlement of the parties is binding and can not be contested. Precisely in this solution of 1999, which was later incorporated into the provisions of the first Rules of the Court of Honor (Art. 9) in 2002, we can find the origin of the so-called preliminary mediation procedure, as the most important institute of the Court's procedure. Preliminary mediation procedure has proven to be the most successful tool in this type of ADR through almost two decades of application, and in all its specificities that make it different from the "classic" concept of mediation. This procedure wasn't formally a part of the Court's procedure in the 1999 Statute, but only a preliminary stage before the procedure could formally be started, and it became an official part of the Court's procedure in 2002. The idea of binding nature of the settlement experienced several years later its legal fulfillment in the provisions of Art. 13 of the 2005 Enforcement Act, which includes the settlement concluded in proceedings before the Courts of Honor in the list of enforceable documents. Rules of the Court do not limit the parties in their attempts to reach an amicable agreement—several hearings can be conducted if the authorized person (Executive Secretary or another authorized employee of the Court) deems it necessary. With these rules, the preliminary mediation procedure is approaching „classic“ mediation in its procedural provisions, and the executive secretary/another authorized employee is approaching the role of the mediator, because they apply many mediation techniques and skills in an effort to resolve the dispute amicably, for which they have also completed training for mediators. Many of the provisions of the 1999 Statute regulating the Court's procedure have not changed significantly with the 2002 Rules. Some of them are also contained in the new Consumer Alternative Dispute Resolution Act (OG 121/16), which implements the EU Directive, so significant changes to the Rules weren't necessary.

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<sup>4</sup> In this situation, certain provisions of the Criminal Procedure Code were applied, namely the provisions about the injured party and the injured party as plaintiff (Art. 65L p. 2 of the 1998 Statute)



## 2.4. Rules of the Court (2007)

The development of the Court's procedure can be further observed through the provisions of the 2007 Rules (OG 11/07), which represent a significant substantive and nomotechnical improvement compared to the 2002 Rules. Thus, the 2007 Rules introduced new substantive and procedural provisions that emerged as necessary based on the Courts practice in the period between 2002 and 2007. In the same period, the first Croatian Consumer Protection Act (OG 96/03) was passed in which the legislator did not decide to introduce any provisions on CADR despite such suggestions by the Croatian Chamber of Trades and Crafts. The authors believe that this was a missed opportunity for Croatian legislation to be enriched by the solution on CADR, for which there was a good foundation in the legal acts and practices of the Courts of Honor of the Croatian Chamber of Trades and Crafts and the Croatian Chamber of Economy. By comparing the provisions of the 2007 Rules with previous solutions, it's evident that all the main principles of the procedure (such as independence of the Court, legality of work, expertise and independence of judges and other members of the Court, confidentiality, transparency, amicable settlement of disputes, simplicity of the procedure) were retained, while some areas were further improved based on the practical experiences of the Court. This particularly relates to preliminary mediation procedure which was given a whole new Article (Art. 19) that regulates it. The solutions of this article are precisely the result of a way in the Court's practice that has shown itself to be very user-friendly, accepted by the parties, and particularly justified in resolving consumer disputes, where the main object of the dispute is to resolve it by concluding a settlement between the parties. Paragraph 3 of Article 19 is notable here, because it stipulates that before starting the preliminary mediation procedure, the claimant's complaint can be forwarded to the reported trader for a response, with an invitation to give his proposal for an amicable solution to the dispute. This encourages both parties and, in particular, the trader, to resolve their dispute by means of a compromise that is formalized by concluding a settlement. This solution also highlights, again, the similarity between preliminary mediation procedure and mediation as regulated by the Mediation Act (OG 18/11), so appropriate education of all persons that conduct this procedure becomes important. Regarding other requirements for the expertise of persons conducting the procedure, a prerequisite for performing the functions of the President of the first and second-instance Council is now a law graduate with bar exam. Limitation periods for submitting the complaint to the Court are extended from 3 months to 6 months (subjective limitation period) and from 6 months to 12 months (objective limitation period), which indicates a path towards harmonisation with the provisions of the CADR Directive (Art. 5) and the CADR Act. (Art. 9. paragraph 1. point 4). Although the principle of simplicity of the procedure for the parties continues to apply, both for consumers and traders, provisions that strengthen their discipline have been elaborated in further detail. For example, the procedure may be terminated by decision of the Court's Executive Secretary if the claimant does not supplement his complaint when needed in order for the Court to be able to act upon it (Art. 18, paragraph 5 of the 2007 Rules and Art. 17, paragraph 1, point 4 of the CADR Act). More detailed solutions (Art. 20. p. 5 of the 2007 Rules) were made for delivery of documents for reasons of efficiency, so that procedure would not be delayed due to unsuccessful delivery, which was, for many years, a major problem of regular Croatian judiciary. It is important to note that, although the provisions of the earlier acts did not explicitly state that the Court carries out the procedure based on complaints of foreign nationals (cross-border disputes), there were no obstructions for it either. However, the 2007 Rules define this clearly in Article 17, paragraph 3. This solution demonstrated that the Court also followed European public policies in its practice, which were codified precisely in the CADR Directive, with the aim of encouraging CADR in cross-border disputes through harmonisation of legal acts. Furthermore, if we compare solutions from the current, 2017 Rules with the solutions from the Directive or CADR Act, we can find an interesting similarity in the provisions of Article

24, paragraph 5, point 3 of the 2007 Rules with the Article 9, paragraphs 2 and 5 of the CADR Act, and Article 5F of the Directive. Namely, this provision allows a single judge to reject the complaint if he or she finds that for any (other) reasons it is not possible to commence or conduct the procedure, and like the CADR Act provides the possibility of rejecting the complaint on the grounds that the dispute is frivolous or vexatious or if dealing with such a type of dispute would seriously impair the effective operation of the ADR body.

## **2.5. Rules of the Court from 2007 to 2017**

The 2007 Rules detail mandatory content of the complaint, along with a new provision that the complaint must be understandable and that it must be signed by the claimant. This indicates the consistency of the procedure rules, starting from the period between 1999 and 2007 and all through the current 2017 Rules. During this period, a significant novelty was introduced in the provisions of the 2007 Rules, with its 2008 Amendments, by introducing consumer representatives to the Council of the Court, after the adoption of the 2007 Consumer Protection Act, which introduces CADR to Croatian legislation for the first time (Art. 130 of the CPA). Representatives of consumers were included in the Court Councils with the first Amendment to the Rules in 2008 on the principle of equal representation to the representatives of the traders (Art. 1 of the 2008 Rules)<sup>5</sup>. The principle of voluntariness of procedure before the CADR body is contained in the Directive (Art. 1) and the CADR Act (Art. 3). It has existed, as a consumer's right, in the procedural rules of the Court since the beginning (1994 Statute) and through all legal acts which followed thereafter. Although the voluntary nature of the procedure for the consumer itself is not explicitly prescribed, it derives from all the other procedural provisions of the Rules which stipulate that the procedure can not be initiated without the consumer's request, i.e. that no sanctions are foreseen for the absence of the consumer to participate in the procedure, and the legal consequence of non-participation of the consumer is termination of the procedure. The authors consider that such provisions are necessary in order to achieve one of the basic principles of CADR - the principle of effectiveness.

## **3. HOW THE COURT OF HONOR OF THE CCTC CONTINUOUSLY ADOPTED EU POLICIES OVER THE COURSE OF ITS PRACTICE**

From the given overview of the procedure before the Court of Honor of the Croatian Chamber of Trades and Crafts in consumer disputes from the 1999 Statute to the current 2017 Rules, it is evident that the procedure adhered to the principles established by the European Commission with its Recommendation 98/257/ EC on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes. The Recommendation highlights the principles of independence, transparency, adversarial principle, effectiveness, legality, liberty and representation by a third party. At the same time, Croatia was still far from adopting its first (2003) and second (2007) Consumer Protection Act. The 2007 Act mentions CADR for the first time, while also establishing the Court as one of five competent CADR bodies. Taking into account its adherence to the aforementioned Recommendation, it's evident that the Court “welcomed” the 2007 Consumer Protection Act with a fully developed CADR procedure already in place. Following the adoption of the 2007 Consumer Protection Act, as we stated before, an important addition to the 2007 Rules (Art. 1 and Art. 3) was made by including consumer representatives in the Councils of the Court, as well as ensuring that they're equally represented in all consumer disputes. The Act also provided for co-financing of the CADR bodies from the state budget funds, along with funding from institutions such as Croatian Chamber of Trades and Crafts where the CADR bodies operated. This co-financing enabled significant activities in the forthcoming period aimed at increasing visibility of the Court of

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<sup>5</sup> This is currently stipulated in Art. 4 and Art. 15 of the 2017 Rules.

Honor among general and professional public. Thus, the Chamber organized the 1st International Conference on Alternative Dispute Resolution<sup>6</sup> under the headline „ADR - Possibilities of cooperation between the judiciary and economic sector“ precisely in order to promote greater use of alternative dispute resolution of consumer and all other disputes. The title of the conference itself confirms that Croatian Chamber of Trades and Crafts, as a national small business association, recognized the importance of cooperation between the judiciary and the economy in ADR, with the aim of its use for fast and effective dispute resolution at a time when regular courts were heavily burdened with a large number of unresolved cases and cases in which procedures lasted many years.<sup>7</sup>

#### **4. HOW THE COURT OF HONOR BUILT TRUST AND RECOGNITION AMONG CONSUMERS AND TRADERS – PRACTICE WHAT YOU PREACH**

Many years of the Court's practice have confirmed that parties, and in particular citizens as consumers, have recognized this kind of procedure and have been turning to it trusting that the Court will abide by the prescribed principles. The Court of Honor keeps in its archive consumers' letters of acknowledgments and positive ratings of its work. The Court's statistics only corroborate this: thus, the Court has, in the period from 2013 to 2016, resolved more than 45% of all consumer disputes (referred to substantive determination) by concluding a settlement, which also resolves the substantive legal requirement of the consumer, if he has raised such a claim.<sup>8</sup> Given that since 2005, a settlement concluded before the Court of Honor of Croatian Chamber of Trades and Crafts is an enforceable document, and taking into account the duration of the procedure in the observed period from 2013 to 2016, and that the procedure for the parties is free of charge, without the need to hire an attorney, it is understandable why citizens as consumers turn to this court as an alternative (out-of-court) consumer dispute resolution body rather than a regular court. The satisfaction and acceptance of Court's decisions, besides a high (45%) percentage of settlements, and compared to less than 4% of settlements concluded in regular Courts is further confirmed by a very low percentage of appeals. The quality of the Court's work is confirmed by decisions of the Administrative Court, as well as the Constitutional Court of Croatia, whose explanations of decisions make clear that in the procedure of the Court of Honor no violations of prescribed rules or laws were made.

##### **4.1. Interest-based dispute resolving**

Preliminary mediation procedure, at the time entitled peaceful solution or amicable agreement, introduced with the 1999 Statute as a possible dispute resolution method, and with the 2002 Rules fully integrated into the procedure as its first phase, influenced the trust of the parties in the Court's procedure the most. Thus, the preliminary mediation procedure formally became the main tool in solving consumer, as well as all other types of disputes before the Court. It could be said that it represents a mediation *sui generis*, which we argue in view of the extremely diverse terms in professional theory and practice referred to as mediation. The strongest argument for the claim that preliminary mediation procedure represents a mediation *sui generis* is found in the fact that it is primarily an interest-based way of solving consumer and other types of disputes, where the Executive Secretary or another authorized employee uses mediation techniques and skills in order to conclude a settlement.

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<sup>6</sup> The conference is held annually and follows the most current international and domestic developments in the field of alternative dispute resolution, and also addresses other issues related to the efficiency of the functioning of the judiciary and public administration that are important for development and strengthening of competitive economy, with an emphasis on an encouraging business environment and taking into account the needs of entrepreneurs, especially SMEs.

<sup>7</sup> According to Ministry of Justice data, there were 785 561 unresolved cases out of 2.416.744 total in regular courts in 2010.

<sup>8</sup> Before 2013, the Court did not separately monitor the success in resolving consumer disputes, so the settlement percentage of the 31% since 2002 also includes other types of disputes among which consumer disputes account for almost 85%

That was why during implementation of the PHARE 2005 project<sup>9</sup>, one employee from the level of each county chamber completed basic and advanced training for mediators and thus acquired the conditions to enter the Registry of Mediators<sup>10</sup> at the Ministry of Justice, so that all persons who at the CCTC and its county chambers conduct the mediation procedure could obtain necessary professional knowledge and mediation skills. Therefore, a very high rate of settlements concluded before the Court confirms that citizens and entrepreneurs accept such an interest-based way of resolving disputes, which is, in addition, free of charge, fast, simple and does not require participation of an attorney. Precisely with preliminary mediation procedure there is a possibility to take into account the fundamental elements of the consumer-trader relationship, emotions and personal relationship between the consumer and owner of the craft business. Despite all of this, such a way of resolving disputes is not used enough in Croatia or the EU.

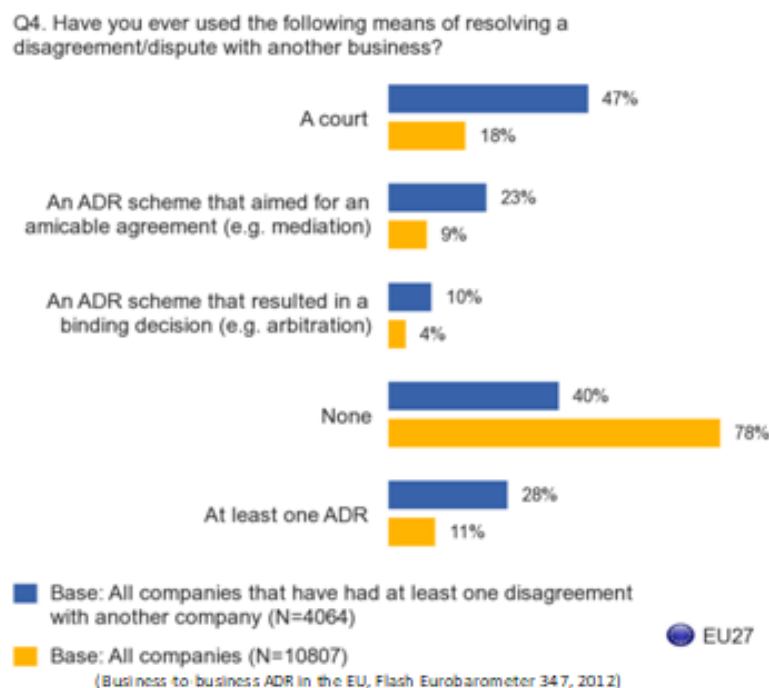


Figure 1: Business to business ADR in the EU, (Flash Eurobarometer 347, 2012)

#### 4.2. Public authority of the Court – ex lege cessation of craft

An important change came with the adoption of the 2013 Crafts Act (OG 143/13), which explicitly states that the Court of Honor of the CCTC performs public authority in respect of the provisions that stipulate that a craft ex lege ceases to exist if the Court of Honor brings the decision on cessation of trading. The authors find that such a provision should have been introduced into the Crafts Act much earlier, ie already in the first Crafts Act in 1993 and with regard to the same provision in Article 38, paragraph 1, item 11. Furthermore, the provision on the proper application of the Civil Procedure Code in the procedure before the Court of Honor is considered to be equally important, as it is apparent from that provision that the Court's

<sup>9</sup> Enhancement of Mediation as an Alternative to Court based Dispute Settlement - PHARE 2005 Programme -The Phare project worth 1. 016. 000 EUR. The project leader was the Ministry of Justice of the Republic of Croatia, with the Croatian Chamber of Trades and Crafts, the Croatian Chamber of Economy, the Croatian Employers' Association and the Croatian Association for Mediation as participants. The project represents a co-operation between law and economy on a common goal - unburdening the courts of all procedures that can be solved in another way - in this case mediation.

<sup>10</sup> <https://pravosudje.gov.hr/registri-i-baze-podataka/6348>

procedure is made to be more urgent and effective, especially compared to regular courts, but not at the expense of rights of the parties.

The 2002 Rules in (Art. 20 p. 2) also introduced the provision that, in case of doubt, the Presidency of the Court<sup>11</sup> gives the interpretation on the appropriate manner of applying the Civil Procedure Code.

#### **4.3. Necessary changes after the CADR Act**

The procedure before the Court of Honor of the Croatian Chamber of Trades and Crafts has been, since its inception in 1994, and especially after the 1999 Statute, already based on some of the principles from Directive 2013/11/EU (which were implemented into Croatian legislation with the 2016 CADR Act), while other principles were introduced gradually until the 2007 Rules. Therefore, there was no need to introduce any significant changes to the procedure, because the adoption of the CADR Act into Croatian legislation only confirmed the Court's pre-existing good procedural solutions and good practice. New developments after the adoption of the CADR Act include encouraging electronic communication between the Court and its parties and online dispute resolution. By this, the 20 years of the Court's know-how has been confirmed precisely through the EU Directive itself and its implementation through the adoption of the CADR Act.

#### **5. BENEFITS OF CADR AT THE COURT OF HONOR**

The Court of Honor, through its preliminary mediation procedure, has all the main advantages of mediation as a way of resolving disputes based on interest, with the help from an impartial, third person without the power to impose a solution. These advantages include, on the one hand, the use of mediation techniques and skills, such as open and closed questions, active listening, empathy, and on the other hand, what we can call “limited voluntariness” of the trader to participate in the procedure. The procedure before the Court is initiated by the consumer and his participation is completely voluntary throughout all phases of the procedure. On the other hand, participation of the trader is completely voluntary only in the preliminary mediation procedure - its first phase. If he doesn't participate, there are no legal consequences, but the procedure continues before the first-instance Council of the Court with the purpose of establishing liability for the breaches stated in the complaint only if the consumer wishes to continue with the procedure. This means that the trader isn't obliged to participate in the second phase of the procedure before the Court Council either, but legal consequences for not answering the duly delivered Court summons can be very significant. The Court can, in accordance with the Art. 22, p. 4 of the 2017 Rules, hold a hearing in the absence of the trader and decide on the dispute, that is, liability of the trader. In the case of established liability, the Court can impose one of the measures prescribed in Art. 14 of the 2017 Rules. It is precisely this difference in the Court's procedure, compared to CADR in front of mediation centres<sup>12</sup> where the procedure for the trader is completely voluntary and without any legal consequence of non-participation, that makes the procedure before the Court more “attractive” to the consumers. This is only corroborated by the fact that, in practice, non-participation of the trader was extremely rare. Other benefits include the fact that the procedure is completely free of charge for the parties, (while most mediation centres charge a fee), is usually finished within 90 days (and in the preliminary mediation procedure often within 30 days), settlement is an enforceable document and legal representation isn't necessary. The possibility of conducting a procedure anywhere in Croatia (all 20 counties) is important for consumers as well as for

<sup>11</sup> The Presidency of the Court is made up of a president who has always been a representative of the highest judicial authorities in the country and is now a judge of the Supreme Court of the Republic of Croatia and with him two deputies from the ranks of craftsmen, and as a professional person, the Executive Secretary of the Court with a legal education and bar examination.

<sup>12</sup> Croatian Chamber of Trades and Crafts has a Mediation Centre, which is notified by the European Commission same as the Court of Honor, but the authors give advantage to the Court

traders. All of the above, and especially the described "limited" voluntariness of the trader's participation in the procedure, presents the decisive factors for consumers to decide (based on information obtained from the consumers themselves) to submit their complaints to this Court, and not a mediation centre or regular court. We could say that mediation centres have just the “carrot”, regular courts just the “stick”, and the Court of Honor of the CCTC has both, which represents its main benefit.

## 6. OPEN QUESTIONS

As one of the most important open questions, the authors see creating and systematically executing future activities of raising awareness among consumers and traders, as well as promoting the CADR bodies, which includes the Court of Honor of the CCTC, in general and professional public through cooperation of all stakeholders, and under guidance of the ministry responsible for CADR in Croatia.<sup>13</sup> For quality implementation of these activities, permanent stakeholder cooperation and the creation of a joint plan are needed, with the funds provided for its implementation. Among open issues related to the procedure itself, the authors see a special challenge in developing solutions for electronic communication between the Court and its parties, creating e-file records, and encouraging parties to use online dispute resolution. It is important to note that the use of the ODR platform of the European Commission has already led to some open questions about its functioning, but such discussion significantly exceeds the scope of this paper.

## 7. CONCLUSION

Court of Honor, as a CADR body of the Croatian Chamber of Trades and Crafts, was since its inception already developing its procedure based on the principles that were brought into Croatian legislation only with the implementation of the CADR Directive, by adopting the CADR Act in 2016. Therefore, no significant changes have occurred in the work of the Court after harmonisation, so good procedural solutions and practice that were already in place have been supplemented with solutions on electronic submission of complaints and electronic communication between the Court and its parties. By this, the existing know-how of the Court has indeed been confirmed. Furthermore, the Court of Honor, as a national notified CADR body, is involved through the ODR Platform in online resolution of cross-border consumer disputes. This could be the first step towards future harmonisation of civil procedure law at the EU level, with the aim of strengthening its Single Market by reducing barriers to cross-border trade. This is why future experiences of the Court, by participating in a single, European CADR, and especially ODR system will also be significant for regular judiciary system. Recognizing the need to strengthen the competitiveness of Croatian economy, in which creating a stimulating business environment represents *sine qua non* of its realization, we believe that the know-how of the Court of Honor of the CCTC can be successfully applied to regular courts. By this, we mean resolving certain types of disputes, such as consumer disputes and small claim disputes, which would require appropriate amendments to the Consumer Protection Act. The authors believe that such changes would, through a pilot project, ultimately contribute to the efficiency of regular courts, increase the use of ADR before and during court procedures, and funds from the state budget would be used effectively to achieve the given objective in regular judiciary, which are reduction of duration of court and out-of-court procedures and faster resolving of long-lasting cases.

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<sup>13</sup> In accordance with Art. 30 of the CADR Act.

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## THE FORMAL - ORGANIZATIONAL CONCEPT OF STATE ADMINISTRATION

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### ABSTRACT

*The Constitution of Republic of Macedonia contains basic provisions in the form of universal juridical principles regarding the status of the central state administration. The Law on the organization and work of the state administration bodies (Official Gazette of the Republic of Macedonia, no. 58/2000), adopted in 2000 by the Parliament of the Republic of Macedonia. The respective law has prescribed general provisions with regard to the organization, structure, competencies and control over the activity and work of state administration authorities at the central level. State administration perform administrative tasks as a part of executive of the Republic of Macedonia. The state administration bodies, are established in the domains, or areas important for performance of functions of state and for efficient exercising of rights and duties of the citizens and legal entities. In servicing clients the administration must respect the personal dignity and the personality of clients, and guarantee a speedy and easy exercising of their rights and legal benefits.*

**Keywords:** *state administration, administrative tasks, ministries, administrative organizations*

### 1. INTRODUCTORY REMARKS

The notion of administration is a central juridical concept on which are based administrative law as a special branch of positive national law and the science of administrative law as a specific scientific juridical applicative discipline.<sup>1</sup> The history of state administration coincides with the development of the state and the organization almost a three thousand years. The development of ancient China marks the emergence of the state administration almost three millennia ago. The Office of the Eastern Doors and the Office of the Western Doors were the first ministries of internal and external affairs. Starting from cameralists in Germany,<sup>2</sup> through Max Weber's concept of rational-legal authority,<sup>3</sup> comes to today's conceptions of state administration.<sup>4</sup> State administration is becoming increasingly important with the emergence of modern society. During the XX century, in the medium developed and highly developed states, the administration has been growing ten to twenty times faster than the population; hence, based on current experience, the development of administrative system is considered a prerequisite for general social and economic growth, because the state administration is a necessary and irreplaceable instrument for regulation of economic and other social processes. Modern state administration means at the same time the end of dilettantism in management. It is no longer, unlike before, work of educated amateurs; as per its methods, the state administration, on a global scale, is the work of specialised experts.<sup>5</sup> Today, in fact, can not be imagined any action (project) without the intermediation of administration; actually, in the most developed societies, it has become constantly present and almost uninterruptedly affects daily public life. In a modern society, the individual is related (connected) to the administration since birth, education, employment, marriage and up to death (that is, from cradle to grave – i.e.,

<sup>1</sup> Невенка Бачанин, *Управно право*, Крагујевац, 2000, pp. 1.

<sup>2</sup> See: Milan Petrović, *Nauka o upravljanju*, Niš, 2011, pp. 23-26.

<sup>3</sup> See: Robert Blažević, *Legitimnost političkih poredaka*, Zagreb, 2010, pp. 84-93.

<sup>4</sup> Dragoljub Kavran, *Javna uprava*, Beograd, 2003, pp. 62; Eugen Pusić, *Nauka o upravu*, Zagreb, 2002, pp. 72-75.

<sup>5</sup> Eugen Pusić, *Nauka o upravu*, Zagreb, 2002, pp. 27.



throughout life, from the registration in the maternity register of births and up to the register of deaths).<sup>6</sup> Etymologically, the term administration is of Latin origin (*administratio*) and as noun implies management, directing, helping, assistance; and as the verb "*administrare*" it is used in the meaning of: to manage, to execute, to decide, to perform the service.<sup>7</sup> The science of administrative law has accepted the standpoint that the expression "administration" has two basic meanings: firstly, according to one of them, the term administration implies a certain circle of entities/ exercisers (bodies or organisations), as a rule, within the state apparatus, which are different from other exercisers of state activity by being entrusted the function of administration; secondly, by the term administration, a specific type of activities is indicated, which, according to some of its specific features, differs from other state activities.<sup>8</sup> In the first case, where the notion of administration is determined by the viewpoint of the exercisers-entities (bodies and organisations) performing administrative activity, the theoretical notion of the so-called the conception of administration in formal-organisational sense. In the other case, where the function or the content of administrative activity is taken as the basis for determining the notion of administration, the theoretical notion of administration in a material-functional sense comes into light. While the material-functional conception of administration tends to determine what the state administration does (what it consists of, what kind of activity or function is that), the formal-organisational conception should determine who does it/performs.<sup>9</sup> Consequently, there are two special considerations of the state administration: first, i.e., as a certain system of administrative organisations, i.e., as one state instrument (formal-organisational notion) and, second, as a separate (particular) form of state activity, i.e., system of certain functions (material-functional notion). From a legal-logical point of view, these two meanings of administration reveal both sides of the same social phenomenon. The formal-organisational meaning and the material-functional meaning, as two main meanings of state administration cannot be separated from one another and treated as independent because there is a symbiosis between them and they are mutually complementary and condition the existence of one another. The two meanings of the state administration appear intertwined and as such, form an inseparable unity with regard to the integral notional meaning of state administration as a product of the existence of state, but, as is it was rightly stated, its immanent capacity and constant companion in the path of development and existence.<sup>10</sup>

## 2. THE FORMAL - ORGANISATIONAL CONCEPTION OF STATE ADMINISTRATION

State administration is an organizational and professional apparatus that serves the public interest by impartiality, implementing applicable legislation, carrying out public services and drafting and applying general state policies. The state administration has a public legal personality and consists of organized structures according to the principle of hierarchy and subordination. The formal-organisational perspective determines the notion of state administration from the aspect of bodies exercising administrative function, as well as from the viewpoint of the form in which that function is exercised. Thus, when the term "administration" is used to denote one part of state apparatus or special types of state bodies or organisation, the organic notion of the state administration is obtained.

<sup>6</sup> Robert Blažević, *Upravna znanost*, Zagreb, 2002, pp. 12-13.

<sup>7</sup> Ivo Borković, *Pojam uprave u teoriji i zakonodavstvu*, Zbornik Radova Pravnog Fakulteta u Splitu, 1975, pp. 55-56; Onesin Cvitan, *Uvod u upravu*, Split, 2002, pp. 16-18; Slavoljub Popović, *Organizacija i funkcionisanje uprave u samoupravnom sistemu*, Beograd, 1978, pp. 3.

<sup>8</sup> *Pravni leksikon*, Zagreb, 2007, pp. 1685.

<sup>9</sup> See: Borče Davitkovski, Ana Pavlovska-Daneva, *Značaj javne administracije za stabilnost institucija u Republici Makedoniji*, Aktuelne Promene u Pravnom Sistemu Država u Regionu, Novi Sad, 2011, pp. 20-21; Eugen Pusić, *Nauka o upravu*, Zagreb, 2002, pp. 29; Nevenka Bachanin, *Upravno pravo*, Kragujevac, 2000, pp. 2.

<sup>10</sup> See: Ermir Dobjani, *E drejta administrative I*, Tiranë, 2007, pp. 15; Драган Милков, *Управно право I*, Нови Сад, 2011, pp. 12-13.

The state as a complex organisation has its own state administrative bodies through which it exercises its authority and performs public service. The state administration bodies are by-product, a natural consequence of the existence of state organisation itself, which constitute an integral coherent entirety that acts within its framework, by realizing its objectives and tasks and cannot be detached from it.<sup>11</sup> The state administration is a powerful factor of the Government of the Republic of Macedonia as an effective holder of executive state power. It establishes a direct link between the state power and the citizens. In the Republic of Macedonia according to Article 95, paragraph 1 of the Constitution of the Republic of Macedonia of 1991, it was established that “the state administration consists of Ministries and other administrative bodies and organizations determined by law”. This formulation leads to the conclusion that the ministries are denoted as the basic organic bearers/holders of state-administrative function, because all these entities, being most important organisational forms of state administration bodies, are explicitly asserted. The remaining state administration bodies are not exhaustively, i.e. successively listed by name, but they were left to be specified by law. So, the Constitution does not state anything about the content and types of state administration tasks (affairs), leaving it to the applicable law. Since it is a very important issue, the Constitution stipulates that the organisation and work of the bodies of state administration are regulated by a law to be adopted by a two-thirds majority vote of total number of Parliament members.<sup>12</sup> Thus, the state administration is elevated to the level of constitutional power, which is a rare example in the comparative constitutional law.<sup>13</sup> Starting point of such a manner of determining the notion of administration are the state administration bodies themselves,<sup>14</sup> i.e., organs and organizations that are entrusted with the administrative function. The administration is a set of organs with the authority of power that are called upon to provide multifaceted tasks of public interest that belong to the state. The administration as a power (function) is present in such perceptions when it is personified through the state bodies that are marked by such positive legal normative acts as administrative.<sup>15</sup> Since the administration in formal-organizational sense includes organs from the composition of state apparatus, in the Republic of Macedonia instead of the designated syntagm (administration in formal-organizational sense), the terminological unification “state administration” is used, which is considered a more precise term. In addition, almost regularly, this term as a common denominator for classical state organizational forms, covers except administrative bodies and certain organizational forms that are separated from the organs of administration, although they do not have certain authoritative authorizations, mainly exercise/perform professional-technical administrative (non-authoritative) tasks. These organizational forms appear under the term “administrative organizations”,<sup>16</sup> and they are included in the content composition of organs of administration, respectively in administration, which implies that the administration in the formal-organizational sense in the Republic of Macedonia is constituted, besides the bodies of state administration and the administrative organizations.

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<sup>11</sup> Невенка Бачанин, *Управо право*, Крагујевац, 2000, pp. 3-4; Невенка Бачанин, *Теорија управног права*, Београд, 1994, pp. 14-16.

<sup>12</sup> Article 95, paragraph 3 of the Constitution of the Republic of Macedonia, Official Gazette of the Republic of Macedonia, no. 52/1991.

<sup>13</sup> Светомир Шкарик, *Научно толкување – Устав на Република Македонија*, Скопје, 2014, pp. 381-382.

<sup>14</sup> “Who speaks for the administration, speaks about the bodies of administration”. – Ivo Borković, *Upravno pravo*, Zagreb, 1981, pp. 5.

<sup>15</sup> See: Види: Невенка Бачанин, *Управо право*, Крагујевац, 2000, pp. 3-5.

<sup>16</sup> The administrative organization is such an organization in which people perform public affairs on the basis of permanent division of authorizations and duties as their permanent profession. There are three features of administrative organizations: public affairs, the permanent division of duties and the powers and professionalism of its members. The listed features/attributes help administrative organizations to differentiate from other organizations. – cited by Eugen Pusić, *Nauka o Upravu*, Zagreb, 2002, pp. 33.

Pursuant to the Law on the organization and work of the state administration bodies of the Republic of Macedonia of 2000<sup>17</sup> consist of ministries, administrative authorities within the ministries and administrative organizations. Ministries as a central state administration are established for the purpose of carrying out state administration activities in one or more administrative areas, respectively are established for state administration tasks in one or more mutually interconnected fields in which case currently there are 15 ministries in total in the Republic of Macedonia:

1. Ministry of Defence;
2. Ministry of Internal Affairs;
3. Ministry of Justice;
4. Ministry of Foreign Affairs;
5. Ministry of Finance;
6. Ministry of Economy;
7. Ministry of Agriculture;
8. Ministry of Health;
9. Ministry of Education and Science;
10. Ministry of Labour and Social Policy;
11. Ministry of Local Self-Government;
12. Ministry of Culture;
13. Ministry of Transport and Communications;
14. Ministry of Environment and Spatial Planning;
15. Ministry of Information Society and Administration.

Ministries are central state administration bodies, while state administration offices are established as regional units of respective ministries of the first instance in the local self-government units. The state administration offices/ regional units of respective ministries in the local self-government unit shall perform administrative and other professional tasks within the administrative areas for which it has been established, in particular:

1. directly implement laws and other regulations and ensure their implementation;
2. decide on administrative matters in the first degree, unless this has been assigned by a special act to central state administration bodies or legal persons with public authority or entrusted to bodies of local self-government units;
3. carry out administrative and inspectional oversight;
4. monitor the state of affairs within its competence and give proposals to central bodies of state administration on measures for improving the state of affairs in specific administrative areas.

The other state administration bodies, which are usually within the composition/structure of ministries for carrying out administrative, professional and other tasks from the competence of ministry, in which case these bodies by law can acquire the capacity of legal person, as they are: directorate, bureau, service, archive, inspectorate and port authority office. Thus, several concrete examples will be presented as follows:

In the composition of Ministry of Justice of the Republic of Macedonia as bodies are established:

- Bureau for representing the Republic of Macedonia before European court of human rights;
- Directorate for execution of sanctions;
- Directorate for Registry Books;

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<sup>17</sup> Закон за организација и работа на органите на државната управа, Службен весник на Република Македонија, бр. 58/2000.

- Bureau of Forensic Expertise.

In the composition of Ministry of Local Self-Government of the Republic of Macedonia as organs are established:

- Bureau for Regional Development;
- State Inspectorate for Local Self-Government.

In the composition of Ministry of Information Society and Administration as organ is established the State Administrative Inspectorate.<sup>18</sup> The other state administration bodies, depending on the type of the organization and the level of autonomy, may be established as autonomous specific state administration bodies as directorates, agencies and commissions, such as for example: Directorate for Free Economic Zones, Agency for Administration, Energy Regulatory Commission of the Republic of Macedonia, etc. Administrative organizations shall be established to carry out administrative and professional tasks whose nature and manner of enforcement require a special level of organization and independence in work and may acquire the attribute of a legal person when prescribed by law. Administrative organizations (institute and office) may be established to perform specific expert and other tasks that call for application of scientific and expert methods and related administrative tasks in the domains for which the ministries are established. The administrative organizations are established as autonomous state administration bodies. Administrative organizations are:

- State Archives of the Republic of Macedonia;
- State agency for geodetic works;
- State agency for statistics.<sup>19</sup>

For better functioning of state administration as a competent and professional administration, the Constitution of the Republic of Macedonia of 1991 prohibits political organization and activities within bodies of state administration. It is a de-politicization and departisation of state administration, as a pillar of state apparatus. Without political de-partisation in the essential sense, the state administration may not be a service to the citizens, because what is professional gives way to the political party.<sup>20</sup> A major problem for the society in the Republic of Macedonia is the dissemination (extension) of state administration, through a numerous agencies, commissions and other independent bodies. There has always been and there still is a danger of sustaining society on a large scale, from the occurrence of enormous administration and quasi-administrative bodies, with the right to impose high fines on various types of misdemeanors, without respecting the legal principles of administrative procedure. An even bigger problem is the political partisation of state administration and the loss of its professional competence.<sup>21</sup> The political partisation of state administration is not a new phenomenon. In the science among the first, Moisey Ostrogorski has registered at the beginning of the XX century, writing about party boards in America. Since then, prey regularly belongs to those who won the elections. Spoils system (also known as the patronage system)<sup>22</sup> from the second half of the XIX century

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<sup>18</sup> Закон за изменување и дополнување на Законот за организација и работа на органите на државната управа (член 6, став 2), Службен весник на Република Македонија, бр. 167/2010.

<sup>19</sup> Закон за организација и работа на органите на државната управа, Службен весник на Република Македонија, бр. 58/2000.

<sup>20</sup> Светомир Шкарик, *Научно толкување – Устав на Република Македонија*, Скопје, 2014, pp. 382.

<sup>21</sup> Ibid.

<sup>22</sup> “Spoils” system (a “spoil” system according to which the winning party receives the whole “spoil of the battle”, which consists of the right to dismiss not only all the incumbent officials, but also all public servants and replace them with their party servants, members and followers) although formally not recognised by our legal system, it is actually fully applied, but with a new element - an attempt to legalise it through the bylaws of the Government of the Republic of Macedonia and the specific administrative decisions of the relevant state bodies. - quoted as per Ана Павловска-Данева, *Од плакат до плакат* –

perfectly functioning in the Republic of Macedonia, regardless of the fact that the candidate for a civil servants or public employees passes a professional exam and undergoes a psychological test that they themselves pay to licensed psychologists.<sup>23</sup> The state administration should be equidistant both from the legislative and from the executive state power. Such a request contains the Weimar Constitution (article 130, paragraph 1) of 1919: “Officials are servants of the whole community and not of a political party”.<sup>24</sup> This allows the possibility to be understood that the public employees should apply the law and should be in the service of the people. The Constitution provides a solid legal framework for state administration in the Republic of Macedonia. The law (constitutional and legal acts) constitutes the basis and the boundaries of the activity of the state administration. This means that the state administration bodies are obliged to strictly adhere to the principles of constitutionality and legality in their working in practice. At the same time, they are autonomous in their working, by not exceeding the constitutional and legal boundaries. It is an independent state administration, bound by the Constitution and laws. The bodies of state administration perform the tasks within their sphere of competence autonomously and on the basis and within the framework of the Constitution and laws, being accountable for their work to the Government. It is the government that determines the principles for the work of state administration, it significantly influences on its organization and supervises its work.<sup>25</sup> It is a convergence of executive and administrative power, which might often be very dangerous for the freedoms and rights of the citizens and the legal entities. It is not disputable that the state administration is bound by the Constitution and the laws. What is disputed is the bound of the state administration by *contra constitutionem* (contrary to the constitution) and flawed laws. This is a major problem faced by the state administration in the Republic of Macedonia in the time period from 1991 to 2014. Every unconstitutional law is a bad law, because it destroys the supreme legal effect of Constitution. But every bad (non-quality) law does not necessarily have to be unconstitutional law. The distinction of unconstitutional from flawed laws, according to Robert Badinter, “represents art, not technique”.<sup>26</sup> Therefore, the quality of legal life in each state depends on the normative content quality of legal regulations, but also on the quality of their implementation into practice itself.<sup>27</sup> In European administrative law, the administration in an organizational sense means a set of administrative bodies that exist vis-à-vis the legislation, that is, the judiciary and the government. Namely, the legal theory that deals with European administrative law, especially in the European Union, the administration is defined as an activity that applies European Union Law in particular cases or in specific situations.<sup>28</sup> Ideal situation would be for the state administration bodies to perform only one function, administrative (and not some other) - and they exclusively (but not some other bodies and organizations). However, social reality opposes strict clichés or templates. Neither state administration bodies are exclusive bearers/holders of administrative activities, nor is their role is limited to exercising one, “pure” administrative function.<sup>29</sup> Hence, it should be taken into consideration the fact that in the contemporary conditions and circumstances of development of the modern state, the administrative function is no longer just a privilege of state administration bodies, but it is such also of other institutions that do not have an exceptional or expressive character of state bodies, but entrusted with

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во *Фотелја*, Утрински весник, 09.03.2008; Наум Гризо, Борче Давитковски, Ана Павловска-Данева, *Јавна администрација*, Скопје, 2008, pp. 190.

<sup>23</sup> Светомир Шкарик, *Научно толкување – Устав на Република Македонија*, Скопје, 2014, pp. 383.

<sup>24</sup> Ibid.

<sup>25</sup> Симеон Гелевски, *Уставни начела за органите на управата*, Зборник на Правниот Факултет “Јустиниан Први” во Скопје, Скопје, 2010, pp. 1-12.

<sup>26</sup> Светомир Шкарик, *Научно толкување – Устав на Република Македонија*, Скопје, 2014, pp. 384.

<sup>27</sup> Dario Đerđa, *Opći upravni postupak u Republici Hrvatskoj*, Zagreb, 2010, pp. 15.

<sup>28</sup> See: Neven Šimac, *Europski principi javne uprave*, Zagreb, 2002, pp. 87-89.

<sup>29</sup> See: Невенка Бачанин, *Теорија управног права*, Београд, 1994, pp. 111-116.

administrative public authorizations<sup>30</sup> to exercise public services,<sup>31</sup> such as public institutions<sup>32</sup> including other social associations as non-state actors. This is precisely why the organisational conception of state administration is defined as a complex organisational system for the exercisers of administrative activities, both within and outside the organisational structure of state. Fundamental innovation that determines the role of the administration in contemporary conditions is that it does not appear rather as an exclusive bearer/holder of imperium - power to command, but as a system of organs whose core purpose is the enforcement of laws, under strong and continuous supervision of government, parliament and the judiciary, and for the purpose to enable the parties to promptly and efficiently exercise their rights and legal interests in practice.<sup>33</sup>

### 3. CONCLUDING REMARKS

State Administration perform administrative tasks as a integral part/constituent component of the executive state power. The conception of administration in formal-organizational sense is determined by the viewpoint of the exercisers-entities (bodies and organisations) performing administrative activity. In fact, the formal-organizational perspective determines the notion of state administration from the aspect of bodies exercising administrative function, as well as from the viewpoint of the form in which that function is exercised. Thus, when the term "administration" is used to denote one part of state apparatus or special types of state bodies or organisation, the organic notion of the state administration is obtained. The state as a complex organisation has its own state administrative bodies through which it exercises its authority and performs public service. In accordance with the Law on organization and work of the state administration bodies of the Republic of Macedonia of 2000 the juridical status and capacity of state administration bodies have ministries, state administration bodies, acting within the framework of competencies of ministries and state administration organizations. In the contemporary conditions and circumstances of development of the modern state, the administrative function is no longer just a privilege of state administration bodies, but it is such also of other institutions that do not have an exceptional or expressive character of state bodies, but entrusted with administrative public authorizations to exercise public services, such as public institutions including other social associations as non-state actors. This is precisely why the organisational conception of state administration is defined as a complex organisational system for the exercisers of administrative activities, both within and outside the organisational structure of state. Essential innovation that determines the role of the administration in contemporary conditions is that it does not appear rather as an exclusive bearer/holder of imperium - power to command, but as a system of organs whose core purpose is the enforcement of laws, under strong and continuous supervision of government, parliament and the judiciary, and for the purpose to enable the parties to promptly and efficiently exercise their

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<sup>30</sup> Administrative public authorizations represent separate legally entrusted public authorizations for performing the administrative activity by non-state entities, in carrying out of their basic economic activities (for example: activities in the field of Postal Telegraph and Telephone traffic, electricity, forestry, etc.) or other social activities (for instance: university education, public information, health, etc.) may also use certain administrative authorisations. – cited by Стеван Лилић, *Управно право*, Београд, 2013, pp. 168.

<sup>31</sup> “Public service” is an activity performed by the institutions in the fields of education, science, culture, health, social protection, child protection, disability protection, as well as in other activities determined by law as a public service. – cited by Закон за установите ( член 2, став 1, алинеја 7), Службен весник на Република Македонија, бр. 32/2005

<sup>32</sup> According to the positive national law of the Republic of Macedonia, it is possible that the public institution is entrusted, within the scope of the working activity for which it has been founded, to perform specific tasks which otherwise constitute an essential part of the classical functions of the state administration. An institution is a form of organisation for the purpose of performing a public service as an activity that is not subordinated to the trade activity, as determined by the law (non-economic activity) and which can be determined by the law as an activity of public interest. – cited by Закон за установите (член 3), Службен весник на Република Македонија, бр. 32/2005.

<sup>33</sup> Наум Гризо, Симеон Гелевски, Борче Давитковски, Ана Павловска-Данева, *Административно право*, Скопје, 2011, pp. 25.

rights and legally based interests in practice. The fundamental human rights and freedoms are indivisible, inalienable, and inviolable and stand at the basis of the entire juridical order. The state administration bodies, in fulfillment of their duties, should respect the rights and legally based interests of parties in the administrative matters, as well as contribute to their realization in practice.

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## COMPARATIVE OVERVIEW OF MONEY LAUNDERING IN CRIMINAL LEGISLATION OF THE REPUBLIC OF CROATIA AND THE REPUBLIC OF SERBIA

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### ABSTRACT

*Money laundering today is the most dangerous corruption offense whose main motive is the acquisition of unlawful property gains by concealing its unlawful origin. The aggravating circumstances in detecting this criminal offense relate to sophisticated perpetration and organization of perpetrators, different modes of execution, but also to its transnational character. In this paper the authors have presented a comparative overview of the criminal offense of money laundering in the legislation of Croatia, a EU Member State and Serbia, an applicant country. The first part of the paper sets forth the basic concepts of money laundering, its characteristics and forms. Furthermore, given is the international legal framework for the suppression of money laundering and, accordingly, the criminal justice framework of Croatia and Serbia with a goal of fighting this very widespread economic crime. A survey was conducted and an analysis of the state and movements of the corruptive criminal offenses of money laundering in Croatia and Serbia in the last two years. Attention was drawn to the jurisdiction in the criminal proceedings as well as the necessary international cooperation of the states in the suppression of this, in most cases, transnational criminal offense. Concluding considerations include de lege ferenda proposals to improve the normative legal framework and measures are proposed to prevent money laundering in order to successfully combat this progressive financial crime of today.*

**Keywords:** money laundering, corruption, economic crime, EU, Croatia, Serbia

### 1. INTRODUCTION

Transnational organized crime today is, in addition to the terrorist threat, a threat to human civilization in peacetime, as well as its achievements. A special problem today are countries in transition that are in the phase of economic change, have no established legal and institutional mechanisms for combating crime, are very vulnerable and can not adequately protect their national interests. Criminal groups liberally use the current situation in these and other countries, expanding their affairs, and greatly affecting political and other developments in these areas. Organized crime groups have multiplied illegal property gains from various illegal activities, including illegal production and narcotics trafficking, smuggling of weapons, human trafficking and human organs. Particularly active is the post-communist mafia, primarily Russian and Albanian, who had a strong breakthrough in the US and other developed countries, took over the narcotics market and other businesses. There is evidence that a large number of banks are associated with criminal groups and that they carry out suspicious financial transactions with the aim of legalizing criminal profits.<sup>1</sup> A similar situation exists in the former Yugoslavia where during the war and in the aftermath of the war, an ex-YU mafia has been formed that has crossed all borders and barriers, with the aim of achieving enormous financial

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<sup>1</sup> Nikač Ž, *Međunarodna policijska saradnja*, KPA, Belgrade, 2015, p.48-55.



gains and power in newly-established states. The development of organized crime was favored by the slow release of the relics of the past and the later beginning of transition. In order to conceal unlawfully acquired criminal proceeds, its legalization, retention and use of the funds, organized criminal group carry out operations known as money laundering. It is a process that includes one or more criminal activities with the aim of concealing the traces of criminal money, its "laundering" and then reinvestment into legal financial flows for the purpose of using it and retaining the benefits. Laundered money is further used to finance new criminal activities and acts of terrorism,<sup>2</sup> which is particularly dangerous for states and the international community in the current migration crisis in the world. The social response to organized crime and money laundering has its legislative and operational aspect. At the international level, several important international documents were adopted, and based on these, the states have adopted national anti-money laundering regulations. The operational aspect includes the measures and activities of states and specialized international organizations in combating money laundering at the local, regional and global level. Similarly, Croatia, which is now a member of the EU, has adapted its legislation and activities to the EU, as well as Serbia, which has applied for admission to the EU and is in the process of the harmonization of standards and practices. Both countries have ratified relevant international documents and adopted national criminal and other anti-money laundering regulations.

## 2. CONCEPT, TYPES AND CHARACTERISTICS OF MONEY LAUNDERING

Money laundering is a term that has long been believed to stem from a prohibition period in the United States. However, the term came into use later when a Mafia accountant Meyer Lansky, after the conviction of the famous Al Capone for tax evasion, applied one of the first money laundering techniques by opening of numerous accounts in Swiss banks. Lansky further improved the technique through the so-called concept of loan repayment that can be used to record illegal money through foreign bank loans, which is recorded as business income or tax deduction.<sup>3</sup> After the famous Watergate affair in the United States (1973), the term money laundering was first established in the media and then in the professional public. Money laundering today is linked to the criminal offenses of illegal production and trafficking of drugs, theft and smuggling of vehicles, trafficking in human beings, prostitution and other forms of organized crime.

- a) Money laundering means criminal activity of illegal entry or withdrawal of money in or out of a country, in order to launder illegally acquired money in banks that perform such transactions for profit.<sup>4</sup> This is an attempt to legalize the proceeds obtained by a criminal offense or other unlawful acts of the so-called main or predicate criminal offense. Clean money is then reinvested, invested in legal flows and uses in banking, trading, sales, investment, entrepreneurship and other economic activities.<sup>5</sup>
- b) Money laundering is not an individual act, but a process that, according to the concepts in the professional literature, has multiple phases: placement, layering and integration.<sup>6</sup>

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<sup>2</sup> Mijalković S, Bošković G, Nikač Ž, *Međunarodno-pravni napori u sprečavanju finansiranja terorizma prljavim novcem*, Strani pravni život, br. 1/11, Institut za uporedno pravo, Belgrade, 2011, p.109–128.

See more: Nikač Ž, Božić V, *International Criminal Police Cooperation and EU Countries in the Fight Against Terrorism with Reference to the Republic of Serbia as a Candidate for Membership*, Tematska monografija “Integralna bezbednost Republike Srbije,” FPSP, Belgrade, 2017, p.235-250.

<sup>3</sup> Katusić-Jergović S, *Pranje novca - pojam, karakteristike, pravna regulativa i praktični problemi*, Hrvatski ljetopis za kazneno pravo i praksu no.o2/07, vol.14, Zagreb, 2007, p.619-642.

<sup>4</sup> Op.cit. in note.1, p.97-98.

<sup>5</sup> Palijaš D, Hržina D, Biluš A, *Preventivni sustav i kazneni progon pranja novca*, Pravosudna akademija, Zagreb, 2017, p.4-5.

<sup>6</sup> Cindori S, *Sustav sprječavanja pranja novca*, Financijska teorija i praksa 31(1) 2007, p.56. The Financial Crimes Enforcement Network -FinCEN described the process of money laundering through the three mentioned phases.

The placement stage is the initial stage of money laundering, where cash is usually introduced into financial flows and is used for purchases of different valuables. Funds acquired through criminal activities are introduced into legitimate business flows, and this usually occurs in smaller amounts (street sales of narcotics, prostitution, trafficking in human beings), but also in larger amounts (sales of larger quantities of narcotics, weapons smuggling, robbery, corruption). The aim is to avoid the possibility of identifying the origin of money and entities that carry out the money laundering activities. At this stage there is a real possibility of detecting dirty money when it is much easier to detect the origin and nature of money. Especially cash in high amounts causes attention and suspicion about the origin of the money, so the perpetrators try to transfer it to lesser amounts. According to current regulations, most banks and financial institutions are under obligation to report all bigger cash transactions, and the potential for detection at this stage is extremely high.<sup>7</sup> The layering stage is a stage that includes multiple transactions that conceal the right origin of the funds, all with the aim of concealing the traces of the money source. These are individual legitimate transactions that have the illegal purpose of extracting funds from an illegal source. In this sense, known techniques are used such as: exchange and smuggling of currency, funds transfer, shell companies, insurance companies, box office and resident mail, use of import-export companies, manipulation of accounts, guarantees, bonds and securities, gambling, offshore zone operations and cash purchases.<sup>8</sup> At this stage, there are more transfers between banks, then telegram, telephone and modern Internet funds transfers between accounts opened in different names, in several countries and for different types of purchases.<sup>9</sup> The integration phase is the stage in which actors permeate their funds into the economy and the financial system, and mix them with legitimate funds. At this stage there are very popular money laundering techniques that include:

- the establishment of anonymous companies in countries where there is protection of privacy, followed by legal loans from the "clean" money funds and increase of revenues with the possibility of rejection of the tax due to the repayment of the loan and collection of interest for the loan;
- sending fictitious invoices that overestimate the value of the goods, on the basis of which money launders can transfer funds from one country to another and have formal proof of origin of the funds;
- transfer of money to a legitimate bank from a launderer's bank because such (suspicious) banks can be purchased in countries that are tax havens.

At this stage, it is also very difficult to detect money sources, which is the goal of money laundering. "Dirty" money is further reinvested in lawful businesses or criminal affairs, while part of the funds is spent on personal spending of the perpetrators.<sup>10</sup>

- c) Money laundering techniques are very different and numerous, so we will only remind ourselves of the most important manifestations in practice. The most common money laundering mechanisms are: simulated commercial transactions (in the country or abroad), through service agencies (marketing, brokerage), banking and financial institutions (money transactions) and others.<sup>11</sup>

The following techniques are popular in the doctrine and practice of financial transactions:

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<sup>7</sup> Op.cit. in note.5, p.5-9.

<sup>8</sup> *Ibid.*

<sup>9</sup> Iljkić D, *Pranje novca u domaćem i stranom zakonodavstvu*, FIP – Financije i pravo, Vol.3, No.1, Zagreb, 2015, p.37-58.

<sup>10</sup> *Ibid.*, p.38-39.

<sup>11</sup> Bošković G, *Metodika otkrivanja i dokazivanja krivičnih dela pranja novca*, MUP RS, Bezbednost no.3/05, Belgrade, 2005, p. 401–443.

- smurfing (building a deposit), which involves breaking large amounts of money into smaller ones, which do not go over the limit amounts and cause no suspicion
- overseas banks that perform transfer of money that launderers sent over offshore accounts in countries that have a banking secret system and allow anonymous use of accounts for any purpose and amount
- alternative banking that exists in some countries (Asia) permits undocumented deposits, withdrawal and transfer of money, while institutions of this type do not leave written evidence, work on trust and are out of control of government; when depositing money, the launderer uses non-official evidence (e.g. a cut playing card or postcard whose one half is retained by the launderer and the other is forwarded to an overseas banker) and after the presentation of his half he can withdraw the money (without risk of detection when taking out the funds)
- fictitious companies are established companies for money laundering that take dirty money to pay for fictitious goods and services, which provide the illusion of legitimate transactions through fake invoices and accounting balance
- investing in legitimate affairs when the perpetrators are investing dirty money to launder it and often use mediation agencies and casinos, or go through smaller players (cafe clubs, bars, car washes), with the possibility for a legal entity to declare a higher income from the real one.<sup>12</sup>

### 3. INTERNATIONAL LEGAL FRAMEWORK FOR FIGHTING MONEY LAUNDERING

Internationally, at the UN level, the Council of Europe and the EU adopted several international documents that are important for the fight against money laundering and the suppression of the most serious forms of organized crime.

- a) The UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988)<sup>13</sup> is the first comprehensive international document as a framework for combating the illicit production and trade of narcotics. The convention was in continuity with earlier agreements - the International Opium Convention (1912) and the Convention on the Limitation of the Production of Narcotic Drugs (1931). The document represents a powerful step in the fight against traffic in narcotics on an international scale, with the aim of taking preventive and repressive measures against money laundering. UN International Convention for the Suppression of the Financing of Terrorism (1999)<sup>14</sup> regulates the prevention and detection of money laundering in connection with terrorism. The document envisages mandatory incrimination of terrorist financing and promotes a new approach to countering terrorism - demolishing economic levers of power on a global scale.<sup>15</sup> UN Convention against Transnational Organized Crime (2000)<sup>16</sup> is a revolutionary document in the fight against organized crime and its most severe forms. The Palermo Convention has established special investigative trials, methods and organs for combating organized crime and laundering of money that spurs from criminal activities. According to article 12-14, confiscation and seizure of money or property derived from crime or used for these

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<sup>12</sup> Op.cit. in note.3, p.624-626.

<sup>13</sup> Law on the ratification of the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, *Official Gazette SFRJ* no.14/90.

<sup>14</sup> UN International Convention for the Suppression of the Financing of Terrorism, UNTC 10 April 2002, No.38349.

<sup>15</sup> More: Giraldo J, Trinkunas H, *Terrorism Financing and State Responses: A Comparative Perspective*, Stanford University Press, Palo Alto, CA, 2007.

<sup>16</sup> UNCATOC - UN Convention against Transnational Organized Crime, United Nations, Treaty Series, vol. 2225.

purposes, as well as international co-operation in cases of confiscation and loss of property.<sup>17</sup>

- b) Council of Europe Convention on Laundering, Search, Temporary Seizure and Confiscation of Proceeds from Criminal Offenses (1990)<sup>18</sup> is an act made with the aim of creating a common criminal policy and depriving the perpetrators of the proceeds. States Parties undertook to implement adopted measures in internal legislation and practices in order to incriminate the laundering of proceeds from criminal offenses and to deduct profits or property corresponding to those amounts. Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (2005)<sup>19</sup> has replaced the previous one with a remark that the Council of Europe's Framework Decision was adopted before.<sup>20</sup> The Warsaw Convention brings a number of news to address the whole problem of money laundering and threatening the states by funding terrorist groups and their actions as a threat to world peace and security. Financing terrorism is legally treated as a criminal offense and it is important to take preventive measures in the area of money laundering as well as the activities of financial intelligence units.<sup>21</sup>
- c) European Union has adopted several important regulations in the area of money laundering and terrorist financing. Of the most important directives and regulations, the following are emphasized:
- Directive 91/308 EEC of the Council of the 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, OJ L 166,<sup>22</sup>
  - Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering - Commission Declaration,<sup>23</sup>
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  - and terrorist financing, OJ L 309,<sup>24</sup>
  - Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC, OJ L 214<sup>25</sup> and
  - Proposal for a Regulation of the European Parliament and of the Council on controls on cash entering or leaving the Union and repealing regulation (ec) no 1889/2005, COM/2016/0825 final - 2016/0413 (COD).<sup>26</sup>

<sup>17</sup> See more: Božić V, Nikač Ž, *Criminal incriminations based on the United Nations Convention Against Transnational Organized Crime in the criminal legislation of the Republic of Croatia and the Republic of Serbia*, Faculty of Security in Skopje, Book of Proceedings, Tom I, 2016, p. 89-111.

<sup>18</sup> Council of Europe Convention on Laundering, Search, Temporary Seizure and Confiscation of Proceeds from Criminal Offenses, Council of Europe Treaty Series - No. 198

<sup>19</sup> Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, Council of Europe Treaty Series - No. 198, Warsaw, 16.05.2005.

<sup>20</sup> Council Framework Decision of 26 June 2001 on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds of crime, 2001/500/JHA. Official Journal L 182, 05.07. 2001.

<sup>21</sup> Op.cit. in note.9.

<sup>22</sup> Directive 91/308 EEC of the Council of the 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, OJ L 166

<sup>23</sup> Directive 2001/97/EC of the European Parliament and of the Council of 4 December

2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering - Commission Declaration.

<sup>24</sup> Directive 2005/60/EC of the European parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, OJ L 309.

<sup>25</sup> Directive 2006/70/EZ, which sets out the implementing measures for the Directive 2005/60/EZ Official Journal L 214 of 04.08.2006

<sup>26</sup> Proposal for a Regulation of the European Parliament and of the Council on controls on cash entering or leaving the Union and repealing regulation (ec) no 1889/2005, COM/2016/0825 final - 2016/0413 (COD).

The first directive has set high standards and the signatories are mandated to embark on a ban on money laundering in national legislation and to increase cooperation in investigations and prosecution of money launderers.<sup>27</sup> The second directive introduces changes in terms of: inclusion of branches of credit and financial institutions with obligation to report suspicious transactions; the view that the money changers and money transfer services are exposed to money laundering risks; incorporating investment funds into the circle of taxpayers and extending the scope of predicate offenses.<sup>28</sup> The third directive is aimed at preventing the use of the financial system for the purpose of money laundering and terrorist financing, especially in the case of payments exceeding the amount of 15.000 Euros. The Directive foresees that National Financial Offices submit reports on suspicious transactions, more closely determine the actions of money laundering and the financing of terrorism.<sup>29</sup> The last directive, fourth, sets out the precautionary measures and states modification relating to: casinos and payments of more than € 7,500, risk assessment, enhanced customer monitoring, beneficiary information control, introduction of administrative sanctions for the service financial sector, cooperation between financial services of member states, enhanced role of the European Supervisory Authority and protection of personal data.<sup>30</sup> We add that a significant international legal source in this area is also made of the well-known recommendations (40) of the Financial Action Task Force (FATF), within the "G7" club of the most developed countries.<sup>31</sup>

#### 4. NATIONAL LEGAL FRAMEWORK FOR FIGHTING MONEY LAUNDERING

- a) Republic of Croatia has foreseen money laundering as an autonomous criminal offense in art. 265 CC RC.<sup>32</sup> The aforementioned criminal offense has existed in the former CC as Concealment of Illegally Obtained Money (Article 279 CC / 97). In the meantime, the criminal offense has been amended in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime and the Financing of Terrorism (2005) and the Framework Decision of the Council of Europe 2001/500/PUP on money laundering, monitoring, freezing, appropriating and confiscating of assets and proceeds of crime. A special distinction was made in relation to the criminal offense of concealment (art.244.CC) and a clearer demarcation, since the above mentioned part was overlapping with some previous resolutions (before art.236 CC/97). According to art. 265 the criminal offense of money laundering is as follows:
1. Whoever invests, takes over, converts, transfers or exchanges proceeds of crime for the purpose of concealing of its unlawful origin shall be punished by imprisonment for a term of six months to five years.
  2. The sentence in par.1 shall be imposed on whoever conceals the true nature, origin, location, disposition, transfer, rights or ownership of the proceeds, which another person has obtained by illegal means.
  3. The sentence in par.1 shall be imposed on everyone who acquires, possesses or uses the proceeds, which another person has obtained through a criminal offense.
  4. Whoever commits an offense referred to in par. 1 or 2 in financial or other business or the perpetrator is engaged in money laundering or proceeds referred to in paragraphs 1, 2 or 3 of this Article are of high value, will be sentenced to prison of 1 to 8 years

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<sup>27</sup> Op.cit. in note.22.

<sup>28</sup> Op.cit. in note.23.

<sup>29</sup> Op.cit. in note.24.

<sup>30</sup> Op.cit. in note.25.

<sup>31</sup> Op.cit. in note.3.

<sup>32</sup> CC RC, *Official Gazette* no.125/11, 144/12, 56/15, 61/15, 101/2017.

5. Whoever takes action under par.1, 2 or 4 by acting in negligence with regard to the circumstance that the proceeds were obtained by a criminal offense, will be sentenced to prison of up to 3 years
6. If the property gain in par.1-5 was obtained by a criminal offense committed in a foreign country, the perpetrator shall be punished if it is also a criminal offense according to the law of the state in which it was committed.
7. The court may release from punishment the perpetrator from par.1-5 who voluntarily contributes to the discovery of a criminal offense that has resulted in property gain.<sup>33</sup>

In the legal analysis of the criminal offense we point out that already in par.1 there has been some improvement over the previous solution, as it is now possible to have money laundering as a predicate criminal offense, considering that various objects are protected. Par.2 gives a more precise formulation that is identical to the conceptual definition of money laundering under the Law on the Prevention of Money Laundering and Financing of Terrorism, which will be discussed in the forthcoming section. In the event that the legal requirement is not fulfilled that it is the so called third person who conceals the true nature, origin and other elements, it is a classic act of concealing as a subsequent unpunishable offense. Par.3, foresees incriminations provided for in art. 9 par. 1 of the Convention on Money Laundering, which the signatory states are required to provide under national law. Focus is placed on the intention in the commission of criminal acts in the form of acquisition, possession or use of property, for which is known at the time of receipt, that it constituted an illegal income. Par.4 is a qualified form of criminal offense when someone is involved in money laundering (*delictum collectivum*) or has "laundered" property gain of a high value. According to the legal view of the Supreme Court of RH "property gain of great value" in the criminal offense of money laundering under art. 265 par. 4. CC exists if the property gain exceeds 60,000.00 kn.<sup>34</sup> Under par.5 a criminal negligence offense is incriminated when the person did not know, but they could or should have known, and this is a neglect of due diligence. The penultimate par.6 provides identity of standards (not complete) in order to undertake criminal prosecution for the offense of money laundering. It is sufficient that the main offense is punishable by a foreign state as well as Croatia, but it does not necessarily have to be the main (predicate) criminal offense in a foreign state. The same solution has also been harmonized with the provisions of the Convention on Money Laundering, art.9 par.7.<sup>35</sup> The last par.7 provides for an effective remorse as a solution stimulating a perpetrator who voluntarily, through his or hers activities, contributes to the discovery of the main criminal offense of money laundering. We are of the opinion that the actual solution of the CC RC is in line with the relevant norms of international law, especially the EU law of which Croatia is an equal member. In addition to CC, money laundering is also treated by several other regulations of criminal law, including the Criminal Procedure Code<sup>36</sup> and the Law on Responsibility of Legal Persons for Criminal Offenses.<sup>37</sup> Money laundering is further treated by the accompanying laws of financial character, which emphasize: The Law on Foreign Exchange<sup>38</sup>, the Law on Banks<sup>39</sup>, the Law on Credit Institutions<sup>40</sup>, the Law on Payment

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<sup>33</sup> *Ibid.*

<sup>34</sup> Supreme Court RC no. Su-IV k-4/2012-57, 27.12.2012.

<sup>35</sup> *Op.cit.* in note.9.

The author states that some CC RC solutions within this criminal offense are modeled on solutions from CC Germany, §261. Geldwäsche Ab.5,8,9.

<sup>36</sup> Criminal Procedure Code, OG no.121/11, 140/12, 56/13, 145/13, 152/14, 70/17.

<sup>37</sup> Law on Responsibility of Legal Persons for Criminal Offenses, OG no.151/03, 110/07, 45/11, 143/12.

<sup>38</sup> The Law on Foreign Exchange, OG no.96/03, 140/05, 132/06, 150/08, 92/09,153/09, 145/10, 76/13.

<sup>39</sup> Law on Banks, OG no.84/02, 141/06.

<sup>40</sup> The Law on Credit Institutions, OG no 117/08, 74/09, 153/09, 108/12, 54/13,159/13.

Transactions<sup>41</sup>, the Law on Financial Inspectorate<sup>42</sup>, the Law on the Croatian National Bank<sup>43</sup> and the Law on the Protection of Data Secrets.<sup>44</sup> The Law on the Prevention of Money Laundering and Financing of Terrorism<sup>45</sup> has been revised and a new text was adopted in 2017 with a view to harmonize the norms with the legal acts of the EU and the Fourth Directive. According to the proponents' suggestions, the good practices of the entities involved in the prevention of money laundering and terrorist financing have been incorporated into the text as well as the results of the national risk assessment carried out.<sup>46</sup> According to art.3 of the Law, money laundering is defined as: 1. replacement or transfer of assets acquired by crime in order to conceal or disguise the illegal origin or to assist another person in such activities; 2. concealment or disguise of the nature, source, location, disposition, movement, rights related to property acquired by crime; 3. acquisition, possession or use of assets acquired by crime; 4. participation in committing, associating for the purpose of committing, attempting, encouraging, counseling and facilitating any of the activities. Money laundering also includes activities in the territory of another EU member or a third country.<sup>47</sup> It further regulates the National Risk Assessment of Money Laundering and Financing of Terrorism as well as the measures, actions and procedures undertaken by the taxpayers to prevent and detect money laundering and terrorist financing. The following important solution is a due diligence analysis of the customer that starts from the type of transaction, cash and non-cash payments (withdrawals) above 105,000 kn. The law specifically states: manner of conducting in-depth checks, the implementation of measures of establishing and verifying the identity of customers, measures of establishing and verifying the identity of the real owner, the register of real owners and the implementation of measures of ongoing monitoring of the business relationship, the manner of implementation of measures for constant monitoring of the business relationship, due diligence analysis of the customer through a third party, simplified and strengthened due diligence analysis of the party.<sup>48</sup> One of the most important solutions is the statutory obligation to inform the Office for the Prevention of Money Laundering on Suspicious Transactions, Assets and Persons (Art.56-61). The law further includes other subjects, obligations of national and international co-operation, as well as the office, role and tasks of the Money Laundering Prevention Office.

b) Republic of Serbia has foreseen money laundering as an independent criminal offense within the framework of Chapter XX, which includes criminal offenses against the economy. According to art.245 CC RS<sup>49</sup>, the criminal offense of money laundering is as follows:

1. Whoever makes a conversion or transfer of property, knowing that such property is derived from criminal activity, in order to conceal or misrepresent the unlawful origin of property, or conceal or mislead the property facts with the knowledge that such property is derived from criminal activity, or acquires, holds or uses the property with knowledge at the time of receipt, that such property was derived from criminal activity, shall be punished by imprisonment of six months to five years and fined.

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<sup>41</sup> The Law on Payment Transactions, OG no.133/09, 136/12.

<sup>42</sup> The Law on Financial Inspectorate, OG no.85/08,55/11, 25/12.

<sup>43</sup> The Law on the Croatian National Bank, OG no.36/01, 135/06, 75/08 i 54/13.

<sup>44</sup> The Law on the Protection of Data Secrets, OG no.108/96.

<sup>45</sup> The Law on the Prevention of Money Laundering and Financing of Terrorism, OG no.108/17.

<sup>46</sup> Available at: <https://vlada.gov.hr/sjednice/9?trazi=1&datumod=&datumdo=&pojам=&page=7> (15.05.2018).

<sup>47</sup> Op.cit. in note. 45.

<sup>48</sup> *Ibid.*

<sup>49</sup> Criminal Code Republic of Serbia, Official Gazzete no.85/05,88/05,107/05,72/09,111/09,121/12,104/13,108/14 i 94/16.

2. If the amount of money or property referred to in par.1 exceeds one million and five hundred thousand dinars, the perpetrator shall be punished by imprisonment for one to ten years and a fine.
3. Whoever commits the offense from par.1-2. of this Article with the property they themselves gained with criminal activity, shall be punished by a fine prescribed in par.1-2.
4. Whoever commits the act from par.1-2 in a group, will be punished by a prison sentence of two to twelve years and a fine.
5. Whoever performs the act from par.1-2 and could and was obliged to know that money or property represents proceeds of criminal activity, shall be punished by imprisonment for up to three years.
6. Responsible legal person who performs acts in par.1-2 and 5 shall be punished by a fine prescribed for this act if they knew or could have known that the money or property represented proceeds of criminal activity.
7. Money and assets referred to in par.1 to 6 of this Article shall be confiscated.

In the analysis of the criminal offense, we point out that par. 1 gives a broad range of executions of the basic act when the perpetrator performs a conversion or transfer of property, or acquires, holds or uses property for which he or she is aware that it derives from criminal activity and does this with the intent to conceal or false representation of the illegally acquired property. In these cases, the perpetrator will be sentenced from 6 months to up to 5 years in prison and a fine. Par. 2 provides a prison sentence of 1 to 10 years and a fine if the amount of property (money) in par.1 exceeds 1,500,000 RSD. The legislator in par.3 foresees the possibility of carrying out a criminal offense from par.1-2 by using illegally obtained property. Following in the par.4 is the aggravated form of the execution of this criminal offense in a group for which a prison sentence of 2 to 12 years and a fine are foreseen. Subsequent paragraph (5) incriminates the negligent commission of a criminal offense when a person did not know, but could have known about the origin of the property. It is a failure of due diligence for which a prison is sentenced to a prison sentence of up to 3 years. The penultimate paragraph (6) provides for the responsibility of the person responsible for the work committed in par.1-2 and 5, if the person has known, could have known and was obliged to know that money or assets represent the proceeds of criminal activity. Finally (par.7), there is obligatory seizure of money and assets for the actions envisaged in the previous paragraphs. The current solution to the CC RS is largely complementary to relevant international law norms and strives to harmonize with EU regulations, which is particularly important for Serbia's application for the EU membership. In addition to CC, money laundering is also treated by several other regulations of criminal law, including the Criminal Procedure Code<sup>50</sup> and the Law on Responsibility of Legal Persons for Criminal Offenses.<sup>51</sup> Money laundering is further treated by the accompanying laws of financial character such as: The Law on Foreign Exchange<sup>52</sup>, the Law on Banks<sup>53</sup>, the Law on Payment Transactions<sup>54</sup>, the Law on the National Bank of Serbia<sup>55</sup> and the Law on Personal Data Protection.<sup>56</sup> The Law on the Prevention of Money Laundering and Financing of Terrorism<sup>57</sup> was adopted in the form of a new regulation during 2017 with the aim of harmonizing the solution with EU legal norms, given that Serbia is a candidate country for EU accession.

<sup>50</sup> Criminal Procedure Code, OG no.72/11,101/11, 121/12, 32/13, 45/13 i 55/14.

<sup>51</sup> The Law on Responsibility of Legal Persons for Criminal Offense, OG 97/08.

<sup>52</sup> The Law on Foreign Exchange, OG no.62/06,31/11,119/12,139/14 i 30/18.

<sup>53</sup> The Law on Banks, OG no.107/05,91/10 i 14/15.

<sup>54</sup> The Law on Payment Transactions, OG no..3/02,5/03,43/04,62/06,11/09,31/11 i 139/14.

<sup>55</sup> The Law on the National Bank of Serbia, oG no.72/03,55/04,85/05,44/10,76/12,106/12,14/15 i 40/15-SC.

<sup>56</sup> The Law on Personal Data Protectio, OG no.97/08,104/09,68/12-SC,107/12.

<sup>57</sup> The Law on the Prevention of Money Laundering and Financing of Terrorism, OG no.113/17.



According to art.2 money laundering is defined similar to RC (EU) solutions as: a) conversion or transfer of property acquired by commission of a criminal offense; b) concealment or misrepresentation of the true nature, origin, place of destination, movement, disposition, ownership or rights in relation to the property acquired by the commission of the criminal offense; c) acquisition, possession or use of property acquired by the commission of the criminal offense.<sup>58</sup> Obligated persons to which the provisions of this regulation apply are the following entities: financial institutions (banks, exchange offices), investment and voluntary pension fund management companies, financial leasing providers, insurance and related companies, brokerage-dealers, organizers of games of chance, audit firms, payment and electronic institutions, real estate brokers, factoring companies, accountants, tax advisers, postal operators, sales and virtual currency transfer agencies and lawyers engaged in these business operations.<sup>59</sup> In order to prevent and detect money laundering and terrorist financing, entities are obliged to take measures and actions before, during and after the transaction (art.5-56). These activities are preceded by an important activity of risk analysis (art.6) in relation to the taxpayer's business, covering various types of risk (party risk, geography, transactions and services) and in relation to a particular group. By category, the risks can be low, medium and high intensity as well as additional risk categories.<sup>60</sup> The importance of combating money laundering and terrorist financing is highlighted by more important measures and actions: knowing and monitoring the party and business; providing information and data to the Anti-Money Laundering Directorate; designation of an authorized person for the fulfillment of legal obligations; education of personnel; internal control and internal auditing; creation of indicators for identifying suspicious transactions and carriers etc.;<sup>61</sup> More detailed provisions are provided for knowing and monitoring the client and its business, transferring funds, providing services, identifying the identity of the client and the real owner, obtaining the purpose and purpose of the business relationship. Special forms of measures and actions such as enhanced and simplified measures and actions have particular significance.<sup>62</sup> There are legal constraints on dealing with clients that refer to concealing the identity of the client, ban on quasi-bank operations, and limitations on cash payments. Of course, one of the most important solutions is the legal obligation to provide information, data and documentation to the Anti-Money Laundering Directorate, which is also done in accordance with relevant international standards of the EU. The law further includes measures and actions taken by lawyers, public notaries, national and international cooperation in combating money laundering and in particular the place, role and tasks of the Anti-Money Laundering Directorate.

## **5. REVIEW AND ANALYSIS OF REPORTED, ACCUSED AND CONVICTED PERSONS FOR MONEY LAUNDERING OFFENSE IN JUDICIAL PRACTICE**

### **5.1. Judicial Practice in Republic of Croatia**

Table no.1 shows the number of reported, accused and convicted persons for money laundering in Croatia in 2015 and 2016. In 2015, a smaller number was reported than in 2016, while the number of accuses is slightly higher, and those convicted is identical. In 2015 there is a smaller number of reported, 34.21% less compared to 2016, which can be seen as the first positive steps in combating money laundering. Data for the previous 2017 have not yet been published as official and this is why they are not mentioned in this research.

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<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*, art.3.

<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.*

<sup>62</sup> *Ibid.*, art.34-41.

Art.265. CC RC – Money laundering		
	2015	2016
<b>REPORTED</b>	13	38
<b>ACCUSED</b>	11	8
<b>CONVICTED</b>	8	8

Table no.1. Reported, accused and convicted for Criminal Offense from Art.265 CC RC. <sup>63</sup>

## 5.2. Judicial Practice in Republic of Croatia

Table no. 2 shows the number of reported, accused and convicted persons for the money laundering offense for 2015 and 2016. We can immediately notice that there is an equal number of reported and accused for money laundering in 2015 and 2016 years. However, a steep increase in the number of accused in 2016 is noticeable compared to 2015. The same can be attributed to the good initial results of state organs in combating money laundering. Data for the previous 2017 have not yet been published as official and this is why they are not mentioned in this research.

Art.245. CC RS – Money laundering		
	2015	2016
<b>REPORTED</b>	14	13
<b>ACCUSED</b>	8	11
<b>CONVICTED</b>	2	11

Table no. 2. Reported, accused and convicted for Criminal Offense of art. 245 CC RS. <sup>64</sup>

Looking at the relation of reported, accused and convicted persons for criminal offenses of money laundering in the jurisprudence of Croatia and Serbia, the situation is almost similar and without major oscillations. It is only noticeable that Croatia in 2016 is recording almost three times the number of applications compared to Serbia, as well as compared to 2015. There is also a difference in the number of prisoners convicted in RS in 2015 compared to 2016, as well as in both years in the Republic of Croatia.

## 6. CONCLUSION

Money laundering is one of the most dangerous forms of organized crime that has long overtaken the national and regional frameworks, has become a global problem and a par excellence issue in criminal law cooperation. Legislative solutions at the international and national level are a preliminary issue because without good normative basis there are no real opportunities for the state and the international community to achieve more effective results in combating money laundering. Adopted solutions are largely complex due to the fact that money laundering is provided for by criminal, financial and other regulations. In this process, governments, their judicial and law enforcement agencies, as well as lawyers and persons from

<sup>63</sup> DZS, *Punoljetni počinitelji kaznenih djela, prijave, optužbe i osude u 2015. godini*, available at: portal DZS, [http://www.dzs.hr/Hrv\\_Eng/publication/2016/SI-1576.pdf](http://www.dzs.hr/Hrv_Eng/publication/2016/SI-1576.pdf) (20.05.2018).

DZS, *Punoljetni počinitelji kaznenih djela, prijave, optužbe i osude u 2016. godini*, available at: portal DZS, [https://www.dzs.hr/Hrv\\_Eng/publication/2017/SI-1605.pdf](https://www.dzs.hr/Hrv_Eng/publication/2017/SI-1605.pdf) (20.05.2018).

<sup>64</sup> Republički zavod za statistiku RS: *Punoletni učinioi krivičnih dela u Republici Srbiji u 2015 i 2016, prijave, optuženja i osude*, available at:

[http://webzrs.stat.gov.rs/WebSite/repository/documents/00/01/97/01/SB\\_603\\_Punoletni\\_ucinioci\\_KD\\_2015.pdf](http://webzrs.stat.gov.rs/WebSite/repository/documents/00/01/97/01/SB_603_Punoletni_ucinioci_KD_2015.pdf)

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[http://webzrs.stat.gov.rs/WebSite/repository/documents/00/02/19/06/SK12\\_189-srb-punoletni-2015.pdf](http://webzrs.stat.gov.rs/WebSite/repository/documents/00/02/19/06/SK12_189-srb-punoletni-2015.pdf) (20.05.2018)

other professions that are engaged in detecting money laundering. Estimated value of laundered money in one year is 2 - 5% of the global gross domestic product, or \$ 800 billion - \$ 2 trillion. It is a very serious state and international problem, even when it comes to much smaller amounts.<sup>65</sup> The harmonization of EU norms and practices with the law and the EU was carried out in the Republic of Croatia upon accession to the EU in 2013, while RS as a candidate country for EU accession in the process of harmonizing individual chapters (no.23-24) with EU law. The Directives adopted by the EU are of primary importance in the protection of the financial system of the EU and the EU, with the respect of guaranteed freedoms and rights. Accordingly, the relevant international conventions at the level of UN, Council of Europe and the EU are relevant at national, regional and global level. The indispensable part of the anti-money laundering are *lex specialis* regulations such as The Law on the Prevention of Money Laundering and Financing of Terrorism in RC and RS. In review of these laws it was pointed to their most important solutions and among them, particularly at the implementation of in-depth analysis, risk assessment and the obligation to report suspicious transactions with elements of money laundering. The paper gives a special account of the criminal offense of money laundering in CC RC (art.265) and CC RS (art.245), as well as legal analysis of provisions based on developed countries' solutions. The problem is that Croatia and Serbia do not have a long and developed judicial and police law practice in this area, and when detecting money laundering, they have to rely on the solutions of the leading EU countries. In addition, the states have also adopted sound financial regulations that enable the fight against money laundering, and are complementary to criminal law provisions. We are of the opinion that the mentioned legislative solutions are a good basis for undertaking measures and actions in the fight against money laundering. In the light of the *de lege ferenda* proposal, we suggest that consideration be given to the possibility of concluding a regional agreement of the Balkan states in the fight against money laundering, which would make the organs of states and specialized international organizations more operational and mobile.

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<sup>65</sup> <http://www.unodc.org/unodc/en/money-laundering/globalization.html> 20.05.2018

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## **SMEs ENCOURAGING ECONOMIC DEVELOPMENT**

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### **ABSTRACT**

*The structure of the Albanian businesses is the same of that of other economies. It has a predominance of the micro businesses (less than 10 employees), which make 95.3% of the total businesses while small businesses (10-49 employees) make 3.7% (INSTAT, 2016). This significant value SMEs has in total businesses is translated in corresponding contribution in economy. They are important as they generate the biggest number of new ideas, affecting this way the innovation generated by a country. On the same time it is essential to take into consideration the structure of SMEs themselves. There are businesses that go bankruptcy after a while their entrance in the market. This happens as their entry in the market is not the right way, they don't bring anything new in the market and they do not survive as there are a lot of similar companies already in the market. In the same time there are entrepreneurs that bring new ideas, related to the technological innovations and these are the proper businesses that contribute to the economy and society. This paper gives a picture of the Albanian SMEs, their contribution in the economy of the country and their situation in relation to the businesses in the region and in the EU. Albania is inspiring to enter the EU and companies has to be aware of the process. Are they able to compare to the businesses in other countries? Do they have any advantage in the EU market? What do they have to do in the meantime in order to gain competitive advantage in the EU market? The pros and cons of the Albanian SMEs are to be considered in this paper.*

**Keywords:** *competitive advantage, developing country, SMEs*

### **1. INTRODUCTION**

Small and medium-sized enterprises (SMEs) are very important for the wealth of a country in terms of development, economic growth, welfare, and so on. It is entrepreneurship the key driver, which fuels the business and effects positively its prosperity. Therefore it is vital to speak about and analyze SMEs, the entrepreneur and entrepreneurship. It is more important to speak about the situation in Albania, which on 2004 has got the status of the candidate country to enter the European Union and doing its progress toward that path. In reference to this important objective, Albania has improved the situation in general and the ease of doing business in particular. Nevertheless a lot has to be done. There are made a lot of studies on entrepreneurship in developing countries. These studies has to be opened access for all the interested parts in order to give the direct impact on the country. Despite the infrastructure, there is a need of setting the entrepreneurial mindset in order for entrepreneurs to be guided in their new venture not by necessity, but by opportunity. This is realized through early education. At first all educators has to be trained in order to be opened-minded, to foster and support the “Thinking out of the box”. The intellectual capital is the resource to employ in order to make the difference in the global market. The entrepreneurial drive sizes opportunities that will benefit them both personally and professionally. This paper is a reflective evaluation of the situation in Albania regarding SMEs, entrepreneurship and entrepreneurial mindset.

### **2. SMEs AND ENTREPRENEURS**

Small firms constitute more than 90% of the entire business population (Kuratko, 2017, p.12). In the EU market small and medium-sized enterprises (SMEs) represent 99% of the entire

population<sup>1</sup>. The categorization of businesses applied in this paper is by number of employees as below:

*Table 1: Categorization of businesses* ([http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition\\_en](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en))

<b>Company category</b>	<b>No. of employees</b>
micro	<10
Small	<50
Medium-sized	<250

Prosperity and a lot of job positions are generated by businesses started by entrepreneurial individuals. The value of SMEs is translated in the related contribution in the society and economy of a country. Entrepreneurship is a crucial driver for the economic progress and expansion. It is a phenomenon that manifests itself throughout the economy and in many forms with many different outcomes, not always related to the creation of financial wealth (OECD, 2017, p 17). Kërçini (2008) mentions the following contributions of SMEs:

- Solve or alleviate the problem of employment
- Give rise to GDP
- Give advantage to the development of big businesses
- Important contribution on national export/import

Referring to the studies a big amount of new ideas are generated from the small entrepreneurs, affecting this way the innovations coming by one country. It is therefore important the entrepreneurial mindset. Entrepreneurship is an objective for a lot of people as they are encouraged by the possibility to:

- create their fate
- make change
- exploit full potential
- achieve considerable gains
- do what they like to do

People thinking of new venture are not always guided by these reasons. In developing countries entrepreneurship are active in necessity-driven ventures which are considered as unprofitable and inefficient in the long-term. They are labor - intensive and mainly managed by low skilled managers with a low level of professional education. Otherwise happens in innovation-driven economies where most of entrepreneurs are driven by the opportunities in the market (GEM, 2016). Entrepreneurship doesn't happen in an empty space unrelated to everything in around. Wherever a start-up is born, the entrepreneur undertakes a lot of risks as: financial risk, career risk, family and social risk and psychic risk. Institutions provide the environment that may enhance or otherwise discourage start-ups. The entrepreneurial mindset has to be thought also in the cultural context. Creativity is the ability to develop new ideas and to discover new ways of looking at problems and opportunities (Scarborough, 2014). It is something that comes from within the person, but people around has to foster creativity and to be supportive on new ideas. It is not easy to think out of the box, especially when people are not used to. If this is the case it becomes more difficult to apply these creative solution, to innovate, to be an entrepreneur.

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<sup>1</sup> [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition\\_en](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en)

Furthermore, an entrepreneur has to deal with some kind of stress (Boyd&Gumbert, 1983, p 48) to as:

- Loneliness
- Immersion in business
- People problems
- Need to achieve

Despite big businesses develop new ideas, creativity and innovation are distinctive of small, entrepreneurial businesses. Creative thinking has turned out to be a crucial competence, and entrepreneurs lead the way in developing and applying that competence. And entrepreneurship is the result of a disciplined, systematic process of applying creativity and innovation to needs and opportunities in the marketplace (Carraher & Welsh, 2009).

### 3. SMEs IN ALBANIA

The structure of Albanian business population is the same as in other countries. It is dominated by the micro businesses by 95.3% and small businesses by 3.7% (INSTAT, 2016) and data from 2016 show that SMEs comprise 99.9% of total Albanian population, contributing with 81.3% of private employment with added value of 66.3% (INSTAT, 2016). Implementing the Small Business Act for Europe (SBA), Albania has implemented some key points of the SBA as one-stop shop implemented on online start-up procedures and also the e-procurement portal. As by Albania SBA Fact Sheet (2017) the Business Investment and Development Strategy for 2014-2020 came into force on spring 2014 and is progressing well.

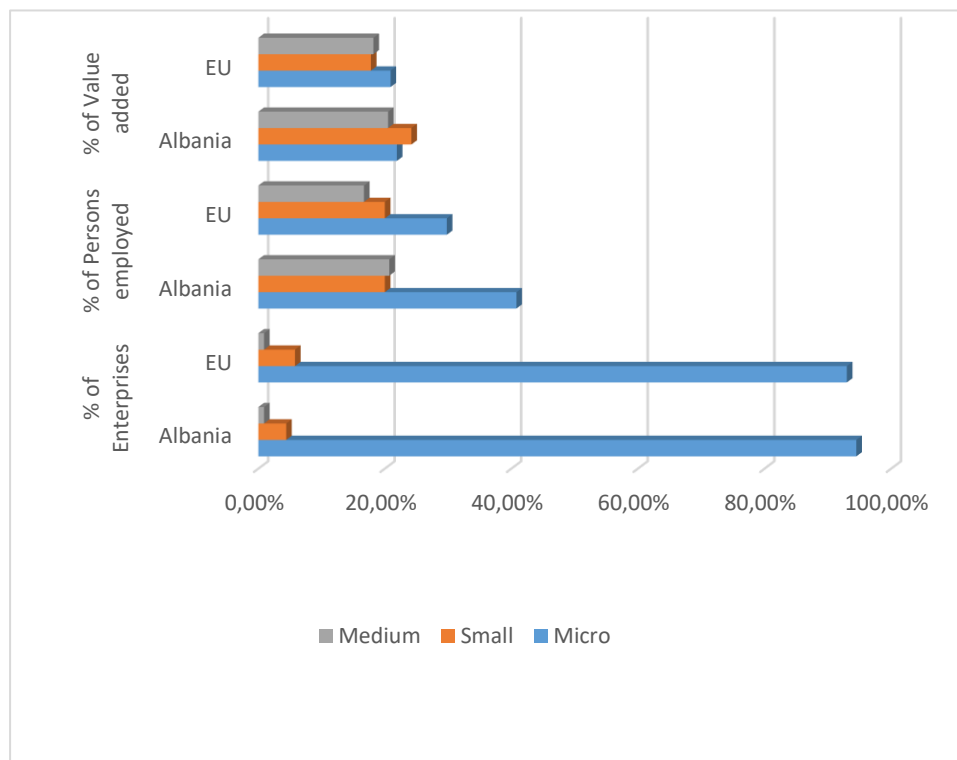


Figure 1. The contribution of businesses by their size in Albania and EU  
Source: 2017 SBA Fact Sheet Albania, pp 2

It is not easy to analyze the situation of entrepreneurship in one country as no single indicator can adequately cover entrepreneurship. There are a set of measures that each captures different aspect or type of entrepreneurship (OECD, 2017).



*Table 2: Factors influencing entrepreneurship performance of a country*  
 Sources: OECD 2017, *Entrepreneurship at a glance*, p 17, available at [https://read.oecd-ilibrary.org/employment/entrepreneurship-at-a-glance-2017\\_entrepreneur\\_aag-2017-en#page17](https://read.oecd-ilibrary.org/employment/entrepreneurship-at-a-glance-2017_entrepreneur_aag-2017-en#page17)

<b>Determinants</b>					
<b>Regulatory framework</b>	<b>Market conditions</b>	<b>Access to finance</b>	<b>Knowledge creation &amp; diffusion</b>	<b>Entrepreneurial capabilities</b>	<b>Culture</b>
Administrative burdens for entry	Competition	Access to debt financing	R&D	Training and experience of entrepreneurs	Risk attitude in society
Administrative burdens for growth	Access to the domestic market	Business agents	University/industry interface	Business and entrepreneurship education (skills)	Attitudes towards entrepreneurs
Income taxes	Degree of public involvement	Venture capital	Technology diffusion	Entrepreneurship infrastructure	Desire for business ownership
Labor market regulation	Public procurement	Crowdfunding	Broadband access	Immigration	Entrepreneurship mindset

Literature on necessity and opportunity entrepreneurship shows that opportunity entrepreneurs in developed countries are more likely to be successful than necessity entrepreneurs in terms of growth rate in sales and employment (Brunjes&Diez, 2016, p154). In Albania most of business is engaged in service, annual growth of GDP is 3.4 (WB, 2016) focused more on services (value added on GDP 53%) unemployment is 13.7 (INSTAT, 2017) and there is not a firm stability in reforms. It's more likely for households to individualize more easily necessity than opportunity (the number of new businesses for 2016 was 31377, 55% of which were in the service sector) but while managing the new venture people improve their capacities related to management and innovation. People engaged in the tertiary level of education is considerably high. The country has undergone reforms in education system and entered entrepreneurship courses in all levels as part of “Business Investment and Development Strategy 2014-2020” regarding Entrepreneurship. There are also organizations as Kulturkontakt, Albanian-American Development Fund, Junior Achievement, etc. that promote the entrepreneurial spirit and skills of the young generation through the education system and not only. The subject “Basics of Entrepreneurship” is compulsory in vocational education and training. The introduction of e-government portal and e-tax-filing system were important for formalization and also improving the relationship with businesses. It has also established the National Economic Council for setting the dialogue between government and business representatives. It needs time for these courses to set an entrepreneurial mindset in the new generation. It's important for them to develop creativity and engage in innovation. Not all people has the talent of identifying an opportunity in the market based on a new idea. This is a skill to be identified and developed in the new generation. In Albania there is the human capital, but the country continues to suffer from brain drain and this perhaps may be a sign of poor institutions which has not yet found the right policies to govern businesses in general and entrepreneurial activities in particular. Without a favorable business environment, SMEs may face barriers to growth (OECD, 2017). Innovation centers and incubators need to be promoted in order to foster entrepreneurial ambitions. Another ongoing problem with which the country is faced is the weak property rights and contract enforcement, problems that have a negative effect on investments.

#### **4. WHAT DO ALBANIAN SMEs DO TO GAIN COMPETITIVE ADVANTAGE**

Regarding entrepreneurship there are two sets of characteristics: entrepreneurial capacity, which is the ability of entrepreneurs to react to new opportunities; and entrepreneurial

opportunity environment, which comprises the country conditions that create opportunities for entrepreneurs (Carraher&Welsh, 2009, p 14). There are the government programs that influence entrepreneurial capacity through the strength of the education system, the availability of entrepreneurship training programs, and also the general cultural and legal environment. Entrepreneurship education programs (in developing countries) currently appear to have an insignificant impact on the attitudes and entrepreneurial intentions of those subject to them. Finding the reason for this is now badly in need of investigation (Williams&Gurto, 2016). It can be related to the programs themselves (Drishti, Kruja, Curcija, 2016), but also to other factors (watch Table 2). As Albania has advanced in its way to European Union, it has entered in networks in order to implement projects related to entrepreneurs too. On 2015 Albanian joins COSME (Competitiveness of Enterprises and Small and Medium-sized Enterprises Programme), which aims to strengthen the competitiveness and sustainability of SMEs. The one-stop shop, e-portal and other facilities has created ease to do business. It is important not to discuss about new businesses themselves, but the kind of businesses they are, the ideas they are implemented. This is why it is important to foster entrepreneurial mindset since early education and think of the idea of academic entrepreneurs. In this way education institutions would encourage and support creativity and innovation, people would be more open-minded. It is important also that a lot of research that is carried on entrepreneurship in developing countries and specifically in Albania, to be opened-access in order to really affect the proper stakeholders.

## 5. CONCLUSION

It is important considering some points before giving the conclusions.

- Albania has openly expressed the desire to join the EU
- SMEs are very important for the country and has to get the proper attention
- Opportunity-driven ventures are considered more effective and long-lasting than necessity-driven ventures
- It is important to encourage entrepreneurial mindset.

On June 2014 European Council has granted Albania the status of candidate country for EU membership. Therefore it is important to discuss about entrepreneurship in view of the reforms to undertake but also to consider the short and long-term strategy to enter the European market. It is something government has to decide in terms of policies to enhance business, especially entrepreneurship. In the national level it is created the National Economic Council for promoting the cooperation between institutions, improving the business climate in the country and protecting legal right of entrepreneurships through consulting and assisting entrepreneurs in their new ventures. The structure of businesses in national level is the same as elsewhere, dominated by SMEs. The problem for the Albanian businesses is that the most of entrepreneurs consider the new venture as the last measure for surviving. That is not enough for having businesses that make difference and long last in the market, not only national but also international market. But regarding the developing countries there is a recognition that necessity- and opportunity-drivers can combine when taking into account the motives of individual entrepreneurs and also these motives can change over time (Williams, Gurtoo, 2016, pp 147). Educational programmes may be improved if they were better promoted and adjusted to the needs of SMEs. As technology is widely used (66.4% of people use internet) there may be effective online courses, on-site coaching and mentoring services and entrepreneurial learning should be included in the development of teachers and trainers (OECD, 2017). The courses on Entrepreneurship and New Ventures has to lead in building personal recognition for the challenges and rewards of entrepreneurship and to fire up the development of new ideas worthy for initiating a professional career.

It is essential to consider Entrepreneurship not only for business students or vocational education in business-administration. Creativity can come from everyone and people has to be aware to grasp the opportunity and enter in the business world.

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## LEGAL AND ECONOMIC MECHANISMS OF INSTITUTIONAL SUPPORT OF IMPLEMENTATION OF EUROPEAN PROJECTS IN VIEW OF THE EUROPEAN UNION LAW

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### ABSTRACT

*Intensification of social and economic development of European Union member states, including Poland, is possible as a result of support for implementation of projects in various areas, coming from European funds. Support for implementation of European projects is regulated with legal norms of the European Union law. Basic principles concerning granting of assistance for implementation of European projects are contained in the European Union primary law, especially in the Lisbon Treaty, which consists of the European Union Treaty and Treaty on functioning of the European Union and they concern permanent development of Europe the basis of which is the sustainable economic growth. Pursuant to the cohesion policy implemented in the European Union the EU law – on one hand – details the principles of obtaining support from the European Funds, and on the other hand – allows in certain scope the public aid from the side of member states, what significantly expands the existing institutional support for implementation of projects. Currently in Poland in the period of programming for the years 2014-2020 the possibility of co-financing projects from EU funds takes place within the European Funds and other special programs. The purpose of the article is the explanation of norms of the EU law in the scope of support for implementation of European projects with special consideration paid to the situation of Poland and forming remarks de lege lata and de lege ferenda.*

**Keywords:** *European funds, European Union law, Projects*

### 1. INTRODUCTION

Implementation of European projects is co-financed from the European funds in the scope of community cohesion policy being conducted. Scope of support for European projects is defined by the European Union law and the Polish law, as well as the current strategy of EU development which was formulated in the document Europe 2020. Singling out of a separate category of European projects of European projects (Project Management Institute, 2008; 2013) (the category of European projects includes also pre-accession projects implemented in the states aspiring to EU membership) is justified and arises from approval in UE of cohesive and formalized legal, institutional and methodological support in the scope of support for projects. Moreover, the standardization of procedures, a system of notions and principles (concentration, partnership, compliance, additionality, programming) of taking advantage of support in the scope of funds allows for integration of participants of European projects exceeding the borders of particular member states. European projects on account of their variety and specific purposes are implemented within the European programs which are regulated with detailed legal norms of EU and Poland.

The purpose of this article is the explanation of norms of EU rights in the scope of support for implementation of European projects with particular attention paid to the situation of Poland and forming remarks *de lege lata* and *de lege ferenda*.

## **2. SUPPORT OF IMPLEMENTATION OF PROJECTS IN VIEW OF THE EUROPEAN UNION LAW**

The European Union, pursuant to the Lisbon Treaty, (Treaty of Lisbon, 2007) is a uniform international organization possessing legal entity pursuant to art. 47 of the European Union Treaty (Treaty on European Union and the Treaty on the Functioning of the European Union, 2016). The European Union also is a legal entity on the grounds of international law, expressing itself in the right to conclude international contracts (*ius tractatum*), the right of legations (*ius legationis*), the right of accessing international organizations and the capacity to act in legal proceedings. Moreover, the European Union is a legal entity pursuant to the national legislation of all member states (Barcz, Górka, Wyrozumska, 2015). It should be emphasized that the European Union acts only within the limits of competence bestowed to it by member states (principle of bestowing competence), what was confirmed by the Tribunal of Justice of the European Union in the verdict in the case *van Gend & Loos* (Judgment of 5.02.1963 – case 26/62 *van Gend & Loos*). In the scope of bestowed competences the law of the European Union has priority in relation to the national law of particular member states, what also directly is connected with the principle of effectiveness of the European Union law (*effet utile*), which assumes „the necessity of reaching the assumed result in the appropriate manner” (Barcz, Górka, Wyrozumska, 2015). One should also state clearly that the law of the European Union in member states is not foreign law but a part of particular normative systems. Therefore, in principle, the law of the European Union in collusive situations takes precedence ahead of the national law. Also the principle, pursuant to which the European Union is authorized to regulate issues connected with support for projects in the European Union member states, should be considered. Projects, including European projects, are implemented by public law and private law entities – natural and legal entities and the so-called legal entities without corporate status. Pursuant to art. 3 of the Treaty on functioning of the European Union, the exclusive competence reserved for the European Union, in the scope of which the EU has the exclusive right of legislation is, *inter alia*, „establishment of the rules of competition necessary for functioning of the internal market”, „common trading policy” (Treaty on European Union and the Treaty on the Functioning of the European Union, 2016). Whereas, the shared competences include, *inter alia*, internal market and economic, social and territorial cohesiveness (Treaty on European Union and the Treaty on the Functioning of the European Union, 2016). Therefore all kinds of support which may breach the rules of competition in the European Union must be regulated and compliant with the EU law so that the limits of allowed public aid for public and private and legal entities which often implement various projects, are preserved. As the general principle, regulating the consent for granting aid for implementation of projects (from the side of European Union as well as from the side of member states), one could point out to art. 3 section 3 sentence 1 and 2 of the European Union Treaty, which states that: „the Union establishes the internal market. It acts for the benefit of continuous development of Europe the basis of which is sustainable economic growth and stability of prices, social market economy with high competitiveness aiming at full employment and social progress as well as high level of protection and improvement of environment quality. It supports the scientific and technical progress.” (Treaty on European Union and the Treaty on the Functioning of the European Union, 2016) In this regulation the particular attention should be paid to the principle of sustainable development and the principle of social market economy deriving from the doctrine of ordoliberalism. Both principles not only allow for but also order the introduction of aid from the side of the European Union or member states if it is compliant with these regulations.

The principle of sustainable development is based on the sustainable development concept (Adamczyk, Nitkiewicz, 2007; Cordonier-Segger, Khalfan, 2012; Boyle, Freestone, 2012; Baker 2003), which pursuant to the preamble of the Treaty on the European Union is treated in the EU law as the founding rule (Kielin-Maziarz, 2013), and therefore it should be taken into account in implementation of economic and social progress. The principle of sustainable development does not refer only to environment protection, but it should be reviewed in the economic sphere, as well as a principle of integration (Winter, 2004). Pursuant to the policy of cohesiveness, implemented in the European Union the European Union law, on one hand regulates the possibility of obtaining support from European Union, and on the other side allows to a certain extent for public aid from the side of member states, what significantly expands the existing institutional support for implementation of the project. Support of the projects from the European structural and investment funds is regulated by appropriate regulations of the European Parliament and the Council (EU), which is directly applied and can have direct effect in legal systems of all member states:

- Regulation of the European Parliament and the Council (EU) No. 1303/2013 of 17 December 2013 establishing common provisions concerning the European Fund of Regional Development, European Social Fund, Cohesiveness Fund, European Agricultural Fund for the Rural Areas Development and European Marine and Fishing Fund and establishing the general regulations concerning the European Fund of Regional Development, European Social Fund, Cohesiveness Fund and European Marine and Fishing Fund and derogating the regulation of the Council (EC) No. 1083/2006 (Official Journal of the European Union, L 347 of 20.12.2013),
- Regulation of the European Parliament and the Council (EU) No. 1301/2013 of 17 December 2013 regarding the European Fund of Regional Development and detailed provisions concerning the goal „Investments for growth and employment” and regarding the derogation of the regulation (EC) No. 1080/2006 (Official Journal of the European Union, L 347 of 20.12.2013),
- Regulation of the European Parliament and the Council (EU) No. 1304/2013 of 17 December 2013 regarding the European Social Fund and regarding the derogation of the regulation (EC) No. 1081/2006 (Official Journal of the European Union, L 347 of 20.12.2013),
- Regulation of the European Parliament and the Council (EU) No. 1300/2013 of 17 December 2013 and regarding the derogation of the regulation (EC) No. 1084/2006 (Official Journal of the European Union, L 347 of 20.12.2013),
- Regulation of the European Parliament and the Council (EU) No. 1305/2013 of 17 December 2013 regarding the support of development of rural areas by European Agricultural Fund for Rural Areas Development (EFRROW) and regarding the derogation of the regulation (EC) No. 1698/2005 (Official Journal of the European Union, L 347 of 20.12.2013.),
- Regulation of the European Parliament and the Council (EU) No. 508/2014 of 15 May 2014 regarding the European Marine and Fishing Fund and regarding the derogation of the regulations (EC) No. 2328/2003, (EC) No. 861/2006, (EC) No. 1198/2006 and (EC) No. 791/2007 and the Regulation of the European Parliament and the Council (EU) No. 1255/2011 (Official Journal of the European Union, L 149 of 20.5.2014).

It should be pointed out that the projects are often implemented by entrepreneurs, and therefore one should consider the problems of support for implementation of projects in the context of business activity and allowed forms of support for entrepreneurs. All support of the state for the development of entrepreneurship, therefore also for the projects must be compliant with the European Union law, and specifically with art. 107 and 108 of the Treaty on Functioning of the

European Union (Treaty on European Union and the Treaty on the Functioning of the European Union, 2016), within which the framework of allowed state assistance was defined. One should also clearly state that every kind of aid granted by the state cannot distort of competition pursuant to art. 107 section 1 of the Treaty on functioning of the European Union. The European Union law regulates the allowed state aid in the Regulation of the Commission (EC) No. 800/2008 of 6 August 2008 regarding some kinds of aid as compliant with common market in application of art. 87 and 88 of the Treaty (general regulation regarding the block exemptions), (Official Journal of the European Union, L 214 of 9.8.2008). Pursuant to art. 1 section 1 items a-i of the Regulation applies as to the following categories of aid: regional aid, investment aid and for employment for the small and medium business sector, aid for starting businesses by women, aid for environmental protection, aid for consulting services for the small and medium businesses sector as well as participation of the small and medium businesses sector in fairs, aid in a form of increased risk capital, aid for research, development and innovations, aid in training, aid for employees in particularly disadvantageous situation of disabled employees (Regulation of the Commission (EC) No. 800/2008 of 6 August 2008 regarding some kinds of aid as compliant with common market in application of art. 87 and 88 of the Treaty (general regulation regarding the block exemptions), Official Journal of the European Union, L 214 z 9.8.2008). Moreover, the European Union law regulates the issue of de minimis aid which is treated as minor aid and does not require notification by a member state. Pursuant to the Regulation of the Commission (EU) No. 1407/2013 of 18 December 2013 regarding the application of art. 107 and 108 of the Treaty on functioning of the European Union to the de minimis aid (Official Journal of the European Union, L 352 of 24.12.2013) the aid which does not require notification amounts to 200 000.00 Euro granted within three years. This is particularly important for small and medium business sector, implementing projects.

### **3. SUPPORT FOR IMPLEMENTATION OF PROJECTS FROM EUROPEAN FUNDS AND OTHER EUROPEAN UNION PROGRAMS**

Principles of functioning of European funds are connected with the following principles: partnership, additionality (of co-financing or supplementation), subsidiarity, decentralization, concentration, programming, regional policy. Priorities and goals of development of the European Union were formed in the strategy Europe 2020 (European Commission, 2010), in which three basic horizontal policies were specified, pursuant to which each project with participation of European Funds is assessed. These are: sustainable development, equality of chances and information technology society. In the years 2014-2020 the following distribution of European funds was approved among member states ([http://ec.europa.eu/regional\\_policy/en/funding/available-budget/](http://ec.europa.eu/regional_policy/en/funding/available-budget/)): Austria - 1.24 billion; Belgium - 2.28 billion; Bulgaria - 7.59 billion; Cyprus - 0.735 billion; the Czech Republic - 21.98 billion; Germany - 19.23 billion; Denmark - 0.553 billion; Estonia - 3.59 billion; Greece - 15.52 billion; Spain - 28.56 billion; Finland - 1.47 billion; France - 15.85 billion; Croatia - 8.61 billion; Hungary - 21.91 billion; Ireland - 1.19 billion; Italy - 32.82 billion; Lithuania - 6.82 billion; Luxembourg - 0.059 billion; Latvia - 4.51 billion; Malta - 0.725 billion; Holland - 1.4 billion; Poland - 82.5 billion; Portugal - 21.47 billion; Romania - 22.99 billion; Sweden - 2.11 billion; Slovenia - 3.07 billion; Slovakia - 12.99 billion; Great Britain - 11.84 billion. The basic support of projects from the European Union are the European structural and investment funds, i.e.:

- European Fund of Regional Development – the main goal of the fund is the support for sustainable development in the European Union regions,
- European Social Fund – the main goal of the fund is the support for projects implemented in Europe, concerning employment and investment in human resources of Europe (employees, young people, job seekers),

- Cohesiveness Fund – – the main goal of the fund is the support for projects in transport and environmental protection in countries in which the GDP per capita is lower than 90 % of the EU average,
- European Agricultural Fund for Rural Areas Development – – the main goal of the fund is the support for EU rural areas through assistance in solving specific problems of European villages,
- European Marine and Fishing Fund – – the main goal of the fund is the support for fishers in their transition to sustainable fishing practices, as well as for communities residing in coastal areas in local economy diversification ([https://ec.europa.eu/info/funding-tenders/european-structural-and-investment-funds\\_pl#documents](https://ec.europa.eu/info/funding-tenders/european-structural-and-investment-funds_pl#documents)).

European funds are managed by: European Commission together with member states, and the main goals of these funds include creation of economy based on a principle of sustainable development. Among the most important areas the Funds focus on are: ([https://ec.europa.eu/info/funding-tenders/european-structural-and-investment-funds\\_pl#documents](https://ec.europa.eu/info/funding-tenders/european-structural-and-investment-funds_pl#documents)):

- scientific research and innovations
- digital technologies
- support for low-emission economy
- sustainable management of natural resources
- small businesses.

Moreover, the European Union set up additional investment funds, dedicated for reaching special purposes, including:

- European Union Solidarity Fund - established in order to grant support in case of serious natural disasters
- Pre-Accession Aid Instrument – dedicated to grant support for candidating countries and potential candidates for the European Union.

European Union also set up the following financial instruments aimed at supporting the following projects:

- JASPERS and JASMINE – their goal is financing the technical support which is necessary to prepare large investment projects
- JEREMIE – aims at facilitation of access to micro-financing for business community from small and medium business sector
- JESSICA – its goal is support for development of urban areas.

Apart from the existing European Funds the European Union earmarked special funds for the following programs:

- Horizon 2020 – the goal of the program includes stimulating of research work, support of international cooperation,
- COSME – the goal of the program includes facilitation of access to markets in the territory of the European Community and also beyond it,
- for small and medium business sector,
- „Connecting Europe” – the goal of this program is financing of strategic investments in infrastructure as well as development of information and communication technologies,
- Erasmus+ - the goal of this program is facilitation of internships abroad for young people,
- Creative Europe – the goal of this program is supporting culture (cinema, television, music, literature, theater, cultural heritage, etc.)



(<https://www.funduszeuropejskie.gov.pl/strony/o-funduszach/zasady-dzialania-funduszy/fundusze-europejskie-w-polsce/>).

#### 4. POLAND AS BENEFICIARY OF EUROPEAN FUNDS

Currently Poland is the largest beneficiary of European funds, and for the years 2014-2020 the European Union earmarked 82.5 billion Euro. Funds in Poland are usually spent on projects connected with transport infrastructure, innovativeness, environmental protection, power generation, education, culture, employment and counteracting social exclusion (<https://www.funduszeuropejskie.gov.pl/strony/o-funduszach/zasady-dzialania-funduszy/fundusze-europejskie-w-polsce/>). Apart from non-refundable subsidies the European Union also grants loans and credits being the refundable instruments. In compliance with the Perspective for the years 2014-2020 there are six national operational programs manager by the Ministry of Development:

- Intelligent Development Program – focused on research and development, transfer of technologies and innovations,
- Infrastructure and Environment Program – connected with energy efficiency and renewable sources of energy,
- Knowledge, Education and Development – addressed to young people wishing to start their businesses,
- Eastern Poland Program – concerning start-up platforms, innovativeness as well as foreign expansion,
- Digital Poland Program – transferring funds for construction of wide-band internet networks,
- Technical Assistance Program – securing funds for development of institutions involved in administration of European Funds as well as institutions responsible for project implementation as well as sixteen regional programs managed by Marshal's Offices (Local Self-Government).

Moreover, there are Integrated Territorial Investments the purpose of which is support for development of cities and their functional areas, as well as Programs of European Territorial Cooperation, the purpose of which is the support of cooperation of Polish beneficiaries with foreign partners (<https://www.funduszeuropejskie.gov.pl/strony/o-funduszach/zasady-dzialania-funduszy/fundusze-europejskie-w-polsce/>).

Various projects are subsidized within the European Funds. The following specific examples of subsidized projects can be pointed out:

- European Funds for young people: for young people aged below 30 (not studying, not in training and unable to find employment); for persons with particularly difficult life circumstances; for persons wishing to open a startup; for studying persons; for students or Ph.D. students (<https://www.funduszeuropejskie.gov.pl/strony/o-funduszach/fundusze-europejskie-dla-mlodych/>).
- Support for micro-, small or medium business people: for research projects and implementation of innovations, informatization, training, development of operations of a company, ecological solutions, operations abroad (<https://www.funduszeuropejskie.gov.pl/strony/o-funduszach/wsparcie-dla-mikro-malych-lub-srednich-przedsiębiorcow/>).
- European funds without barriers.

Table 1 presents the most important operational programs implemented within European Funds from the moment of accession of Poland to the European Union, taking into account three periods of programming.

*Table 1. Operational programs implemented within the scope of European Funds in three periods of programming (Kozien, 2015, p. 70)*

OPERATIONAL PROGRAMS		
2004 – 2006	2007 – 2013	2014 – 2020
<ul style="list-style-type: none"> <li>• Integrated Operational Program of Regional Development</li> <li>• Sector Operational Transport Program</li> <li>• Sector Operational Program of Development of Human Resources</li> <li>• Sector Operational Program of Increase of Competitiveness of Businesses</li> <li>• Operational Program Technical Aid</li> <li>• Sector Operational Program Restructurization and Modernization of Food Industry and Development of Rural Areas</li> <li>• Sector Operational Program for Fishing and Fish Processing</li> </ul>	<ul style="list-style-type: none"> <li>• 16 Regional Operational Programs</li> <li>• Operational Program Infrastructure and Environment</li> <li>• Human Resources Operational Program</li> <li>• Operational Program Innovative Economy</li> <li>• Operational Program Technical Assistance</li> <li>• Operational Program of Development of Eastern Poland</li> <li>• European Territorial Cooperation</li> </ul>	<ul style="list-style-type: none"> <li>• Program Infrastructure and Environment</li> <li>• Intelligent Development Program</li> <li>• Digital Poland Program</li> <li>• Knowledge Education, Development Program</li> <li>• Eastern Poland Program</li> <li>• Technical Aid Program</li> </ul>

## 5. CONCLUSIONS

Public and private law entities implement various projects. Not all projects are possible to implement independently by particular subjects, what results from economic, legal, social and structural conditions. In some cases it is necessary to have institutional support from the state, which in majority of cases is advantageous for the state, because well-damaged project affects the economic, social, innovative development, improves situation on the employment market and with time generates income to the state budget. However, in relation to institutional support of projects by the state there may be accusations on breaching the principles of free market and competition. For this reason the European Union, bearing in mind the cohesiveness, defined legally admissible forms of support from EU and national funds. States with various level of economic development accessed the European Union in the course of years. For this reason, among main goals of the European Union, beginning from the Treaty of Rome, and especially from the Maastricht Treaty, the cohesiveness policy and regional policy have been implemented which were meant as provision of harmonious development of all EU member states. It assumed evening out of chances and level of economic development of all EU member states. European Union faced a large program in 2004 when the largest expansion of the European Union took place. Ten states, mostly belonging to the former East Block countries controlled by the USSR, accessed the European Union. Absolutely, these countries were not as economically developed as other countries of Western Europe. In order to assure the cohesiveness of internal market it was necessary to develop the offer of European Funds and adjust them with a view of new

member states in order to even out the economic chances of all member states, also through support of implementation of projects by public and private law entities. It became necessary to introduce norms, deciding on allowed support for implementation of projects in order not to breach the rules of fair competition. It should be emphasized that the key principle which the support for implementation of projects is based, are one of the most important principles which the European Union is based, i.e. the principle of social market economy and sustainable development principle. De lege lata it should be stated that the European Union law regulates the issues connected with support of projects implementation by Regulations of the European Parliament and the Council (EU) which are directly applied in legal systems of all member states. It clearly indicates that in this field the UE legislator wishes to introduce uniform principles in effect all over the EU. Moreover, the European Union legislator protects competition on the internal market of the Union by restriction and clear indication of possible forms of institutional support. Apart from European Funds the Union legislator also creates special programs and financial instruments, as well as in the specific scope allows for support of small and medium business sector. One could then state that the system of support for projects implementation is of multi-centric character which in its core is a very advantageous phenomenon. Moreover, the support system is changing, what is necessary from the point of view of changing economic, legal, political and social factors. However it must be stated that multi-centricity of the forms of support requires the holistic regulation, so that the mechanisms of support were easily accessible for potential beneficiaries. Currently, by establishment of various forms of support and the lack of uniform regulation it may happen that the earmarked funds for disinformation and disorientation the funds will not be effectively consumed. These projects are often implemented by entrepreneurs, this is why another issue is a situation of entrepreneurs of small and medium business sector for whom obtaining an institutional support may be a condition for survival and development (Kozien, 2017). Their situation is different, this is why in compliance with the principle of equality from the material point of view (Sarnecki, 2014) the EU legislator made it possible to grant institutional support also on the national level. However it should be stated that within the small and medium business sector one could perceive noticeable differences among micro-entrepreneurs who can run their businesses as a sole employer and medium size entrepreneurs, who may employ up to 250 employees (Regulation of the Commission (EC) No. 800/2008 of 6 August 2008 regarding some kinds of aid as compliant with common market in application of art. 87 and 88 of the Treaty (general regulation regarding the block exemptions), Official Journal of the European Union, L 214 z 9.8.2008). One should point out that the formalized procedures of obtaining funds from the European Funds and other mechanism of support are very restrictive. It is necessary because these are public funds from the European Union budget which consists of the funds transferred by all member states, however in the procedures themselves the limited elasticity should be restricted. Procedure of application, implementation and evaluation of projects is strictly specified with formal and contents-oriented requirements and evaluation of project results. For example, the requirements from the so-called hard projects (investments) at the stage of their preparation, concern the development of feasibility study, however, the completion of a project is subject to evaluation as to maintenance of durability of its results in subsequent years. Next, it should be pointed out that in compliance with development of economy based on knowledge the support from European funds should be transferred in particular to entities implementing innovative projects, and therefore with which it is necessary to cooperate with universities, commercialize results of scientific research, transfer of knowledge and technology into economy (Kozien, Kozien, 2017a). In current European Union legislature there are no appropriate regulations sensu stricto. In reference to the presented remarks de lege lata the possibilities of changing of current situation should be pointed out by presentation of the de lege ferenda remarks.

Firstly, one holistic, uniform system of institutional support in implementation of projects which should be multi-centric and adjusted to current legal, economic, political and social factors, as well as assuming historical conditions. It is also of key importance to have qualified persons in territorial self-government offices of all member states, who would help applicants for European Union funds for implementation of projects. Besides, it is necessary to introduce delimitation of micro-, small and medium entrepreneurs because their economic situation is different (it is difficult to compare a micro-entrepreneur with a medium business owner with 250 employees). Moreover, delimitation as to particular industries should be considered, because, for example entrepreneurs implementing innovative high-risk projects face a completely different situation and have other needs. One should also emphasize that it is necessary to treat small and medium business sector differently in the scope of institutional support for implementation of projects. Thirdly, procedures of applying for EU funds should be simplified by avoiding of rejection of applications for reason of obvious and insignificant technical errors. Moreover, in the scope of applying and controlling of expenditure of funds a principle of restricted flexibility should be applied in case of implementation of projects, assuming taking into consideration of legal, economic and social factors as well as soft treatment of borderline qualifying and controlling values or definition of the division these values belong to, using qualifying and controlling procedures. Fourthly, one should clearly support innovative projects implemented in cooperation with universities by commercialization of results of scientific research and transfer of knowledge and technologies to economy will contribute to scientific and economic development of European Union member states, and consequently of the European Union itself. In this scope the appropriate management of universities is necessary (Kozien, Kozien, 2017b), as well as culture of entrepreneurship based on cooperation of entrepreneurs with universities.

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# THE BANKRUPTCY DRAFT LAW OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

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## ABSTRACT

*The Law on Bankruptcy Proceedings, which is in effect in the Federation of Bosnia and Herzegovina, was passed in 2003 and has undergone two insignificant changes and amendments, while the economic conditions have significantly changed. New circumstances in the development of the economic business impose on the need for passing new legal solutions, stressing the affirmation of reviving lapsed economic entities. This is visible in the suggested legal text by implementing completely new legal provisions about the economic entity reconstruction through a pre-bankruptcy proceeding. Its implementation is supposed to lead to the removal of the very clear problems in the business of the economic entity.*

**Keywords:** *The Bankruptcy Draft Law of the Federation of Bosnia and Herzegovina, bankruptcy, pre-bankruptcy settlements, commercial courts*

## 1. INTRODUCTION

Due to the specific constitutional structure of Bosnia and Herzegovina (BiH) and the division of jurisdiction, the status of legal entities is under the jurisdiction of the entity i.e. Brčko District. The Law on Bankruptcy Proceedings of Federation BiH (FBiH) was for the first time passed and published in Official Gazette FBiH 23/98. Before that, on the grounds of a Statutory law on adopting and implementing federal laws, which are implemented as republic laws in BiH, Compulsory Settlement, Bankruptcy and Liquidation Act of the former SFRY had been adopted.<sup>1</sup> In Republika Srpska (RS) the Law on Bankruptcy Proceedings was adopted<sup>2</sup>, while Brčko District, unlike entity regulations, adopted the Law which regulates the question of bankruptcy, compulsory settlement and liquidation in one text.<sup>3</sup> The Law on Bankruptcy Proceedings of FBiH from 1998 was replaced by a new law in 2003, which underwent changes and amendments in 2004 as well as changes in 2006.<sup>4</sup> In 2016, Republika Srpska adopted the Bankruptcy Law (SZ RS),<sup>5</sup> which outlawed the previous Law on Bankruptcy Proceedings.<sup>6</sup>

<sup>1</sup> See: RIZIVANOVIĆ, E., *Društvene i pravne posljedice otvaranja stečajnog postupka*, Pravni savjetnik, issue 1, January, 2015, page 35., and: RAJČEVIĆ, Marko, *Zakonska regulativa stečaja i likvidacije u Bosni i Hercegovini*, Zbornik radova, Drugo međunarodno savjetovanje, Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse, Neum, June 4, 5 and 6, 2004, page 240. The first grounds for implementing the law in BiH was presented by the yugoslavian Compulsory Settlement, Bankruptcy and Liquidation Act from 1979. See: POPOVIĆ, V., *Novine u stečajnom pravu Republike Hrvatske iz 2016. Godine*, Zbornik radova Četrnaestog međunarodnog savjetovanja “Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse,” Mostar, 2016, page 8.

<sup>2</sup> Official Gazette of Republika Srpska, 67/02, 12/10

<sup>3</sup> Official Gazette of Distrikt Brčko, 1/02. For further information see: Modul 3, *Reorganizacija stečajnog dužnika*, Visoko sudsko i tužilačko vijeće Bosne i Hercegovine, Sarajevo, 2007, page 5. The survival of a bankruptcy debtor had its place in the former system with the Compulsory Settlement, Bankruptcy and Liquidation Act from 1979, which still exists in the same form in Brčko District. See: POPOVIĆ, V., *Novine u stečajnom pravu Republike Srpske iz 2016. Godine*, Zbornik radova Četrnaestog međunarodnog savjetovanja “Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse,” Mostar, 2016, page 5.

<sup>4</sup> Official Gazette of FBiH, 29/03, The Law on Changes and Amendments in the Bankruptcy Proceedings Act OG FBiH, 33/04 / and *The Law on Amendments in Bankruptcy Proceedings* OG FBiH, 47/06.

<sup>5</sup> Official Gazette of Republika Srpska, 16/16

<sup>6</sup> Official Gazette of Republika Srpska, 67/02, 77/02, 38/03, 96/03, 68/07, 12/10, 16/10 and 26/10. On the reasons of adopting the law see: RAJČEVIĆ, M., *O prodaji stečajnog dužnika kao pravnog lica*, Zbornik radova Četrnaestog međunarodnog savjetovanja “Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse,” Mostar, 2016, page 119.

There is a significant number of open bankruptcy proceedings.<sup>7</sup> The data on a great number of untimely procedures was especially worrisome,<sup>8</sup> because there was no norm for regulating the responsibility of the persons in charge for filing a petition to open a bankruptcy proceeding.<sup>9</sup> The new law should speed up the bankruptcy proceeding duration. Moreover, the pre-bankruptcy proceeding / financial-operative restructuring of the company is defined. The fines are more strict, the decrease of expenses is predicted as well as a higher level of work control over bankruptcy trustee. Another novelty is selling the bankruptcy debtor as a legal entity.<sup>10</sup>

## 2. THE BANKRUPTCY DRAFT LAW OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

The reform agenda for BiH in the period 2015-2018, in the section referring to the “Business climate and competition” states that “better laws and practices are necessary for the investor’s protection, ... more efficient frames for insolvency with the change of the Law on Bankruptcy Proceedings, which will introduce a new institute, a “pre-bankruptcy proceeding”, with financial reconstruction of the debtor as a goal, in order to avoid the bankruptcy with an aim of keeping the work places and continuing with basic operations of the economic societies.”<sup>11</sup> On December 13, 2016, the House of Representatives of the Parliament Assembly of FBiH approved with the majority of votes the Bankruptcy Draft Law (Draft) and put it up for a public discussion.<sup>12</sup> The Draft provides a new name, so the Law on Bankruptcy Proceedings should be named The Bankruptcy Law.<sup>13</sup> The Draft adapts pre-bankruptcy and bankruptcy proceedings, legal consequences of pre-bankruptcy and bankruptcy proceedings, the reorganization of a bankruptcy debtor unable to make payments on the grounds of a bankruptcy plan and international bankruptcy. It consists of eight thematic units, i.e. it is divided into eight chapters.<sup>14</sup>

<sup>7</sup> In the first three months of 2016, 483 notices about bankruptcy or liquidation proceedings were published, 400 of which in FBiH, and 83 in Republika Srpska. In the same period in 2015, almost two times more notices were published, 788 in total, 388 of which in FBiH and 400 in Republika Srpska. The data is available at: Stečaj je pomoć, a ne kazna, LRC BIS, available at: <http://www.lrcbh.com/stecaj-je-pomoc-a-ne-kazna>, visited on April 20, 2017. For the first three months of 2017 there were 457 bankruptcy and liquidation proceedings in total, 346 of which in FBiH and 111 in Republika Srpska, which is 26 less than in the same period in 2016. The data available at: Stečajevi i likvidacije 1. Kvartal 2017, LRCINKASSO, available at: <http://www.inkasso.ba/stecajevi-i-likvidacije-1--kvartal-2017->, visited on April 20, 2018.

<sup>8</sup> Which is why there were problems about not enough bankruptcy estate, both in the possibility for the bankruptcy proceeding and a more significant supplement of the creditor. RAJČEVIĆ, M., *O prodaji stečajnog dužnika kao pravnog lica*, Zbornik radova četrnaestog međunarodnog savjetovanja “Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse,” Mostar, 2016, page 119.

<sup>9</sup> Article 53, paragraph 15 of the SZ RS defines: If a bankruptcy debtor or an authorised representative does not file a petition for a bankruptcy proceeding within 60 days of the day the inability to make payments occurs, they will be fined with a monetary penalty. In the next paragraph it is defined that the legal entity for filing a misdemeanor proceeding for the established misdemeanor is *Agency for Intermediary, IT and financial services*.

<sup>10</sup> There is many controversies regarding this method, so it is questionable if its application is legitimized and if it was the employee’s oversight which will have consequences such as difficulties in the operating the norms which regulates it. About the problem of conceptual definition in clarity between a company as an object of law and an economic society (in bankruptcy) as a subject of law and the holder of a company, see: RAJČEVIĆ, M., *O prodaji stečajnog dužnika kao pravnog lica*, Zbornik radova Četrnaestog međunarodnog savjetovanja “Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse,” Mostar, 2016, page 126.

<sup>11</sup> The reform agenda BiH for the period 2015-2018, available at: <http://www.fbihvlada.gov.ba/pdf/Reformska%20agenda.pdf>, visited on April 20, 2018.

<sup>12</sup> On January 26, 2017, The Federal Ministry of Justice in accordance with the Conclusion of the House of Representatives of the Parliament Assembly of FBiH, drawn on the 13<sup>th</sup> regular session of the House of Representatives, held on December 13, 2016 and the Conclusion of the House of Peoples of the Parliament Assembly of FBiH, drawn on the 12<sup>th</sup> regular session of the House of Peoples, held on January 29, 2016, determined that the Bankruptcy Draft Law can serve as a basis for the creation of the Bill of law and by which the petitioner is in charge of organizing a public discussion. See: Javna rasprava - Nacrt zakona o stečaju, available at: <https://www.fmp.gov.ba/index.php?part=pregled&id=131>, visited on April 20, 2018.

<sup>13</sup> In most national legislations and in surrounding countries, there is a presupposition that the Law on Bankruptcy Proceedings is an act of a legal procedural nature. However, since it consists of a significant number of material legal acts, the new name is in order because it is more comprehensive.

<sup>14</sup> Which are: Chapter I. Basic Provisions, Chapter II. Basic Procedural Provisions, Chapter III. Pre-bankruptcy Proceedings, Chapter IV. Bankruptcy Proceedings, Chapter V. Debtor Reorganization Proceedings, Chapter VI. International Bankruptcy, Chapter VII. Penalty Provisions and Chapter VIII. Transitional and Final Provisions.



The draft structure is identical to the structure of the law currently in effect, whereas the number of the articles has increased forming a new chapter of the law defining the pre-bankruptcy proceeding, as the most important novelty of the petitioned Draft.<sup>15</sup> Special attention needs to be paid to the goals for bankruptcy proceedings in terms of maintaining the business of the lapsed economic societies and the intention of their revitalization for further operations.<sup>16</sup> The reasons for a bankruptcy proceeding are furtherly defined. According to the article 6 of the Draft, the bankruptcy proceeding can occur if the court determines the existence of grounds for bankruptcy, which are: the inability of the debtor to make payments<sup>17</sup>, the threat of an inability to make payments<sup>18</sup>, not acting in accordance to the bankruptcy plan or if the bankruptcy plan is an act of a treason or an illegal act. There are two new reasons not present in the law currently in effect. They refer to the reorganization of the bankruptcy debtor. The principle of urgency is also affirmed and it is pointed out that other judicial and administrative proceedings resulting from the bankruptcy proceeding must have priority over other proceedings.<sup>19</sup> A novelty to the existing solution is article 18 of the Draft which defines the deadline for bankruptcy proceeding ending.<sup>20</sup> Article 22 of the Draft as an expression of a stricter discipline over the work of all the parties in the bankruptcy proceeding defines compulsory manners implemented by a bankruptcy judge, if the parties do not act according to law. Moreover, article 25 of the Draft defines the way court documents are delivered, as one of the significant phases of the proceeding in which delays often occur.<sup>21</sup> The provisions referring to the bankruptcy trustees bring more novelties and include the age limit to which a person can be named as a bankruptcy trustee as well as introduce clear naming limits.<sup>22</sup> We believe that the Draft lacks a definition of jurisdiction, therefore the need for establishing the Agency for Bankruptcy Trustees Licensing.<sup>23</sup> We believe that limiting a number of proceedings they can participate in is a positive suggestion. In article 107 the way of publishing a decision about opening a bankruptcy proceeding is determined and, among other things, it is planned to publish the decisions on the Financial-Intelligence Agency's website, and the copy of the decision must be delivered to the Tax Administration of Bosnia and Herzegovina, authorised prosecutor's office and Indirect Taxation Authority of Bosnia and Herzegovina.<sup>24</sup>

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<sup>15</sup> The structure of the Draft is the same as the structure of SZ RS.

<sup>16</sup> Article 13, paragraph 1 of the Draft: Pre-bankruptcy proceeding is handled in order to organize the debtor's legal position and its relation to the creditors, in order to continue managing its activities.

<sup>17</sup> The debtor is unable to make payments if it cannot meet its accrued and outstanding payment liabilities. The fact that the debtor has paid or is able to pay the claims of certain creditors, wholly or partially, does not, in itself, mean that it has the ability to make payments. A debtor is unable to make payments if: it fails to pay its outstanding payment liabilities for a period of 60 days or if its account is blocked for a constant period of 60 days.

<sup>18</sup> A bankruptcy proceeding may also be opened because of the threat of an inability to make payments which will occur in the period of 12 months. Only the debtor may file a petition to open a bankruptcy proceeding because of the threat of an inability to make payments.

<sup>19</sup> The contribution to the affirmation of the principle of urgency is the article 23 of the Draft which entails the right for a complaint to the court's decisions and in which it is petitioned that a complaint does not have suspensive effects. According to this petition, a complaint would not delay the execution of the decision, except if it is specifically required by law. With this act it is meant to avoid the proceeding being delayed, which is very often used in practice, when the complaint is filed just for that purpose.

<sup>20</sup> It is determined that the bankruptcy proceeding will be ended within a year and in more complex cases two years.

<sup>21</sup> The suggested article prescribes that the delivery is done publicly with notices on the court's notice board and website (electronic notice board), including cases in which the law provides a special delivery. In certain cases a delivery through "Official Gazette of FBiH" is provided.

<sup>22</sup> The bankruptcy judge monitors the work of the bankruptcy trustee. The bankruptcy trustee can be released and removed from the List of Trustees if it is released in two bankruptcy proceedings. In order to remove doubts about choosing bankruptcy trustees and their relation to judges, it would be efficient if the trustees would be chosen by a random selection method. In order to maintain transparency, the List of Trustees, the proceedings they were participating in, the way they were chosen and other data showing information about their work should be published.

<sup>23</sup> Bankruptcy Trustees are obliged to continuously work on their professional development. Agency for Bankruptcy Trustees Licensing could play a significant role in that respect, among many others.

<sup>24</sup> According to the provisions in effect, there is no possibility to open a penalty provision because there was no authorised initiator determined in accordance with article 53 of Law on Misdemeanors ("Official Gazette of FBiH" issue 63/14).

## 2.1. Pre-bankruptcy settlements in the The Bankruptcy Draft Law of the Federation of Bosnia and Herzegovina as the most significant novelty

The United States of America had a lead when it comes to law related to the bankruptcy avoiding matters.<sup>25</sup> Their reorganization model dates from the 1970s.<sup>26</sup> In different countries there have been different models for dealing with this reorganization and they have mostly belonged to the bankruptcy proceeding. However, there is an even more common tendency of transferring these actions into another proceeding which is carried out before and out of the bankruptcy proceeding, possibly even instead of it.<sup>27</sup> There are numerous examples of such actions, with the changes of the regulations for pre-bankruptcy proceedings, in the countries of Western Europe with highly developed and propulsive economies.<sup>28</sup> More than half of the European Union countries have regulated legal proceedings for the remediation of economic entities or special pre-bankruptcy laws.<sup>29</sup> On March 12, 2014, European Commission proposed a document called Recommendations on a new approach to business failure and insolvency<sup>30</sup> which determines several general principles for national proceedings. Its purpose is encouraging sustainable entrepreneurs to restructure at an early stage in order to prevent insolvency and redirecting future actions.<sup>31</sup> It is pointed out that it is necessary to provide a second chance for honest entrepreneurs in bankruptcy.<sup>32</sup> For the sake of preventive insolvency problem solving the Draft proposes a new institute of a pre-bankruptcy settlement. Because of doubts, criticisms and problems in the legal practise and doctrine,<sup>33</sup> the legislator has decided that the basic, i.e. supervisory role in the pre-bankruptcy proceedings would have to belong to the court's jurisdiction, which we consider a positive solution.<sup>34</sup> The Draft (articles 27-57) proposes that the proceeding should completely be in the court's jurisdiction, because of the reconstruction, whose main aim is to sustain the debtor's activities. The suggested legal regulations propose a way of managing a pre-bankruptcy proceeding, the court's jurisdiction<sup>35</sup>, the trustee's jurisdiction<sup>36</sup>, its obligations and the pre-bankruptcy proceeding duration, which is limited to 150 days from its opening, who can file a petition for opening a pre-bankruptcy

<sup>25</sup> POPOVIĆ, *Novine u stečajnom pravu Republike Srpske*, page 8.

<sup>26</sup> UZELAC, A. Je li uređenje predstečajnog postupka bilo sukladno s Ustavom? *Post festum* analiza više neriješenih procesnih i ustavnih problema, page 10, available at: [http://www.alanuzelac.from.hr/pubs/E18\\_Predstečajni%20postupak\\_ustavnost.pdf](http://www.alanuzelac.from.hr/pubs/E18_Predstečajni%20postupak_ustavnost.pdf), visited on April 20, 2018.

<sup>27</sup> See: Ministry of Justice of the Republic of Croatia, Nacrt zakona o stečaju, Zagreb, December 2014, page 2

<sup>28</sup> UZELAC, Je li uređenje predstečajnog postupka bilo sukladno s Ustavom? *Post festum* analiza više neriješenih procesnih i ustavnih problema, page 10

<sup>29</sup> However, all of these regulations and laws differ more or less and there is still a search for models which would offer optimal solutions in that field. See: Ministry of Justice of the Republic of Croatia, Nacrt zakona o stečaju, Zagreb, December 2014, page 3

<sup>30</sup> European Commission, Recommendations from March 12, 2014 on a new approach to business failure and insolvency, Bruxelles, March 12, 2014

<sup>31</sup> European bankruptcy legislature “is reoriented in the direction of American legislation” and it seeks to destigmatize the bankruptcy debtor along with affirming the options for rehabilitating the bankruptcy debtor. See: The Government of the Republic of Croatia, Prijedlog zakona o izmjenama i dopunama Zakona o financijskom poslovanju i predstečajnoj nagodbi, s konačnim prijedlogom zakona, Zagreb, November 2013, page 5.

<sup>32</sup> The aim of the Recommendation is “to ensure the sustainable entrepreneurship with financial difficulties the access to *national bankruptcy frames* which enable them to restructure at an early stage in order to avoid bankruptcy, and therefore maximise the total value for the creditors, employees, owners and economy in total.”

<sup>33</sup> The disputes and criticisms were related to the division of jurisdiction of executive and judicial power bodies, the insufficient role of the court and the position and protection of the creditor. See: UZELAC, Je li uređenje predstečajnog postupka bilo sukladno s Ustavom? *Post festum* analiza više neriješenih procesnih i ustavnih problema, page 4.

<sup>34</sup> In that way “the managing will meet the demands of the Constitutional rights protection, especially the right to legal protection, independent and impartial court (a tribunal), the equality before the law and the right for ownership.” Ibid., page 28.

<sup>35</sup> According to the article 5 of the Draft, a pre-bankruptcy proceeding can be opened if the court determines the existence of the threat of an inability to make payments. The threat of an inability to make payments exist if the debtor is not able to make payments according to the schedule of maturity within 12 months and if the debtor is late with the payments within 60 days.

<sup>36</sup> The bodies of a pre-bankruptcy proceeding are the court and the trustee (article 27 of the Draft). Like in RS, the option was not a “hybrid” proceeding but monitoring, so the court has the main role. The court in a pre-bankruptcy proceeding: decides on the opening of a pre-bankruptcy proceeding, names and dismisses the trustee and monitors its work, monitors the fulfillment of obligations to the FIA, decides on the determined and disputed claims, decides on ending a pre-bankruptcy proceeding, as on all other matters of a pre-bankruptcy proceeding, if the law does not require another pre-bankruptcy proceeding body. The conditions for naming a trustee are the same as the conditions for naming a bankruptcy liquidator. The trustee stops acting as one on the day a decision is made on the confirmation of a pre-bankruptcy agreement or the day of opening a bankruptcy proceeding.

proceeding,<sup>37</sup> where the debtor's role is emphasized because the creditor needs the debtor's approval for opening this proceeding, and the documents which need to be filed alongside the petition, the court's actions after the petition was filed<sup>38</sup>, a pre-bankruptcy plan, the debtor's business during the pre-bankruptcy proceeding and legal consequences of opening a pre-bankruptcy proceeding<sup>39</sup>. Since a new institute is introduced, it is necessary to start educating all the participants in the business system on possibilities which will be at disposal to the economic societies with difficulties, and it is necessary to implement new acts which are with these Draft put under the jurisdiction of the Minister of State, in order to maintain an efficient bankruptcy system. If the proposed law is not in accordance with the legislations, changes and amendments of other relevant laws, the efficiency of the new law will not be possible, especially with the existing condition of the courts' inefficiency.

### 3. OTHER RELEVANT REGULATIONS

The European Union (EU) lies on the free market values. The protection of the market competition in a broader sense<sup>40</sup> includes both the monitoring system and state aid policy.<sup>41</sup> Help for rescuing and restructuring is very popular in EU,<sup>42</sup> for which it can be said that it has a very emphasized social aspect.<sup>43</sup> State aid policy in the EU puts emphasis on removing market failures.<sup>44</sup> In 2012, BiH adopted the Law on State Aid System in BiH<sup>45</sup> as one of the reform steps that the country has to fulfill on its way to European integrations.<sup>46</sup> The legal frame for the state aid policy control in BiH is to a great extent in accordance to the EU rules, but the process is not completely done. The pre-legal acts are not sufficiently harmonized, which makes it harder for the laws to be applied properly.<sup>47</sup> Surely, it is necessary to emphasize the need for changing the Law on Competition<sup>48</sup> which is not in accordance with EU legal acquis. The competition relationship lies on the principle of equality which guarantees the acquirement of positive economic results.<sup>49</sup> Equality is posed as a demand in three segments: founding and approach to the market, market performance and manner of termination.<sup>50</sup>

<sup>37</sup> Article 32 of the Draft, a pre-bankruptcy proceeding is opened after the debtor's or the creditor's petition, if the debtor gives the approval, before a judicial court which manages the proceeding. If a petition for opening a pre-bankruptcy proceeding is filed by the creditor, they are obligated to file the debtor's approval alongside the petition.

<sup>38</sup> The court will reach a decision on opening a pre-bankruptcy proceeding and name the trustee within eight days after determining that the petition is allowed and legitimate and that a down payment for the pre-bankruptcy proceeding costs has been paid.

<sup>39</sup> Legal consequences of opening a pre-bankruptcy proceeding occur at the moment of putting a decision of opening a pre-bankruptcy proceeding on the court's notice board, and they are in effect for all the creditor's claims to the debtor existing up to the moment of opening a proceeding (article 51 of the Draft).

<sup>40</sup> BUTORAC MALNAR, V., PECOTIĆ KAUFMAN, J., PETROVIĆ, S., *Pravo tržišnog natjecanja*, The Faculty of Law, Zagreb, 2013, page 9.

<sup>41</sup> RIZVANOVIĆ, E., *Državna pomoć u zemljama Europske unije - iskustva za Bosnu i Hercegovinu*, Štamparija Fojnica, 2005, page 64.

<sup>42</sup> State aid granted by the countries of EU should be a matter of public interest. For example, it could be rescuing a company, which would prevent social problems resulting from closing in a zone where there already is a high unemployment rate. See: Communication from the Commission - Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (SL C 249, July 31, 2014, pages 1-28).

<sup>43</sup> RIZVANOVIĆ, E., *Stječajni plan i pozicija države*, Pravna riječ, Udruženje pravnika Republike Srpske, 16/2008, Banja Luka, page 64.

<sup>44</sup> Numerous issues for economic future of the common market are, for example, services of common economic interest, investing in research and development, IT, as well as systematic care for regional development. See: Minivodič za poslovnu zajednicu, *Zaštita tržišnog natjecanja i državne potpore*, page 21, available at: [http://www.bizimpact.hr/download/documents/read/zastita-trzisnog-natjecanja-i-drzavne-potpore\\_6](http://www.bizimpact.hr/download/documents/read/zastita-trzisnog-natjecanja-i-drzavne-potpore_6), visited on April 6, 2018

<sup>45</sup> Official Gazette of FBiH, 10/2012

<sup>46</sup> RIZVANOVIĆ, E., *Fiskalne financije i fiskalni sistem Bosne i Hercegovine*, Mostar, 2016, pages 173-176.

<sup>47</sup> The functionality of this law would contribute to the economic system development, especially to that of small and medium companies. The insignificant amount that is put aside through state aid systems is indicative of the disrespect of European standards, which results in facing domestic economic entities with an unloyal competition. Sistem državne pomoći u Bosni i Hercegovini, zakon i praksa, Centri civilnih inicijativa, Tuzla, BiH, 2015, page 98.

<sup>48</sup> Official Gazette BiH, 48/05, 76/07 and 80/09

<sup>49</sup> ZLATOVIĆ, Dragan, *Nelojalna konkurencija i pravo intelektualnog vlasništva u Bosni i Hercegovini*, Privredna štampa, d.o.o. Sarajevo, 2014, page 101.

<sup>50</sup> Therefore, in the context of contemplating the bankruptcy legislation and efficiency of the legislative norms applications, we must be aware of other significant regulations, such as Company Law of BiH, regulations on the privatization process (as well as the

An important starting point in determining an economic system is the business entity registration,<sup>51</sup> which would necessarily have to be simpler with an aim to attract investments.<sup>52</sup> Moreover, it is necessary to form commercial courts in FBiH<sup>53</sup> in order to fulfill The BiH Action Plan for the Implementation of the Reform Agenda of BiH for the period 2015-2018. The Bankruptcy Draft Law should be seen through a prism of proposing other relevant regulations, especially the issues of economy insolvency and a great number of blocked accounts of economic entities,<sup>54</sup> its reflection on the business system (orderly payments and causing bankruptcy), the position of banks as specific economic societies in that system,<sup>55</sup> which to a great extent determine the position of business entities on the market. It is necessary to point out the Law on Financial Business,<sup>56</sup> which regulates that, effective from January 1, 2017, the deadline for payments in FBiH is 30 days. A special novelty that this law proposes is introducing penalties for those who break payment deadlines.<sup>57</sup> Article 10, paragraph 2 of the Law on Financial Business determines that the regulations of that law do not apply on the payables within the bankruptcy proceeding, including the payables on the basis of debt restructuring in order to increase the profitability and cost efficiency of the entities. As a significant improvement in terms of positive solutions there was an indication of a solution in article 92 of the Draft, which proposes bankruptcy trustees with higher payment priorities.<sup>58</sup> The Constitutional court of FBiH with judgement U-27/15<sup>59</sup> ruled articles 33 and 40 of the Law on Bankruptcy Proceedings of FBiH as unconstitutional (Official Gazette of FBiH, 29/03, 32/04 and 42/06). The articles of the law ruled as unconstitutional can no longer be applied. Therefore, the way in which the settlement order will be determined is questionable, since the unconstitutional regulations of the law can no longer produce legal effects.

#### 4. CONCLUSION

There is an obvious gap in BiH between the official law and the real legal procedure. It is an undeniable fact that bankruptcy as the most complex economic and legal institute, i.e. the existing rules, have not reached expected effects and results. Due to problems in the implementation of the bankruptcy proceeding, the new regulations seek to ensure a prompt bankruptcy proceeding opening, financial and operative debtor restructuring, shortening of the

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position of Agency for Privatization), regulations on economic entities registration, public companies, public procurement, rules of intellectual property.

<sup>51</sup> The registration process is slow, inefficient and as such does not contribute to the development of entrepreneurship. Program ekonomskih reformi za 2016-2018. Godinu, Bosna i Hercegovina, (ERP BiH 2016-2018), Sarajevo, January, 2016, page 81.

<sup>52</sup> In FBiH the government carries out the activities for applying and introducing the economic entities registration procedures through “one stop shop” registration system. Specific measures on the FBiH level, in terms of simplification, have still not been applied. Answers to the Questionnaire, Chapter 20. Poduzetništvo i zapošljavanje, page 180, available at: [http://www.dei.gov.ba/dei/direkcija/sektor\\_strategija/Upitnik/odgovoriupitnik/Archive.aspx?langTag=bs-BA&template\\_id=120&pageIndex=3](http://www.dei.gov.ba/dei/direkcija/sektor_strategija/Upitnik/odgovoriupitnik/Archive.aspx?langTag=bs-BA&template_id=120&pageIndex=3), visited on April 20, 2018.

<sup>53</sup> In *The BiH Action Plan for the Implementation of the Reform Agenda of BiH for the period 2015-2018*, the year 2016 is set as an indicative deadline for the implementation (forming of commercial courts). We must state that none of those changes have been made yet.

<sup>54</sup> According to the report on the blocked accounts in Central Bank's Registry of Legal Entities' Transaction Accounts, February 1, 2018, the total number of blocked accounts is 75 454, and the total number of companies with at least one blocked account is 64 788. The data are available on Central Bank of Bosnia and Herzegovina websites, <https://www.cbbh.ba/?lang=hr>, visited on April 12, 2018.

<sup>55</sup> New regulations of the Law on Banks are in accordance to the regulations of EU, which propose a stronger banks supervision, a risk managing system as well as banks reconstructions with the new Law on the Banking Agency in order to protect the whole financial system and therefore the economy as a whole. The Law on Banks, Official Gazette of FBiH, 27/17.

<sup>56</sup> Official Gazette of FBiH, 48/16, June 22, 2016.

<sup>57</sup> Until now, if a client or customer refused to pay for the goods or services, it was possible to open a legal proceeding before a judicial law. Now, according to article 24 of the Law on Financial Business, the Tax Administration inspectors can fine a debtor who does not respect the payment deadlines.

<sup>58</sup> In a way that the workers or former workers of a bankruptcy debtors are settled before other bankruptcy creditors, except Board members, Supervisory Board members and Revision Board members, with payments within 12 months before the day of opening a bankruptcy proceeding.

<sup>59</sup> The decision is available on the Constitutional Court of FBiH website: <http://www.ustavnisudfbih.ba/hr/index.php>, visited on March 11, 2018.

duration of bankruptcy proceeding and decreasing its costs. In order for these new legal solutions' goals to be reached, it is necessary to coordinate the regulations with effects on the Law on Bankruptcy Proceedings application. The need for reaching a concise, meaningful and above all practical legal solution in this field represents a step towards reaching goals in removing legal and other obstacles for investments in FBiH, which need to bring significant financial means as well as new work positions. In other words, adopting this kind of law should be a step forward in the realization and reach of economic and financial progress. Considering the aims and purpose of the Law on Bankruptcy Proceedings which refers to very important issues for all economic entities and which, alongside other laws, strives to introduce discipline and prompt obligations fulfillment, decrease insolvency, enable economic recovery and remove disorders in the economy. The application and practice will show if the suggested solutions will contribute to the improvement of the business ambient. Therefore, it would be necessary to make the relevant legal frame consistent, to form commercial courts, establish Agency for Bankruptcy Trustees Licensing, educate the market participants about pre-bankruptcy settlements, reorganization of the bankruptcy debtor and the notion of bankruptcy as an institute of general social meaning, as well as define an implementation of the policies and programmes which will promote a new beginning for the entrepreneurs who abode by the regulations, but have gone into bankruptcy.

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## THE EXPORT COMPETITIVENESS OF NAFTA COUNTRIES

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### ABSTRACT

*The paper analyzes export competitiveness characterized using selected trade indicators of NAFTA Member countries. The main goal of the research is to indentify international trade performance and export competitiveness among the NAFTA member states. Results of this research indicate international competitiveness detected by measuring, analysis of the countries' GDP and trade openness, recommendations and proposals in order to realize a higher level of international trade. The methodology of this research includes implementation of different trade performance indicators like intra-industry trade, balance of trade, export as a share of GDP and other relevant indicators.*

**Keywords:** NAFTA Member countries, export, import, export competitiveness

### 1. INTRODUCTION

North American Free Trade Agreement (NAFTA) represents trilateral trade block of USA, Canada and Mexico. The main reason for establishing NAFTA, was to expand trade between the countries by eliminating all trade and investment barriers and to make these countries more competitive in the global marketplace. On January 1, 1994 the North American Free Trade Agreement (NAFTA) between USA, Canada and Mexico entered into force and incorporated the prior Canada-US Free Trade Agreement (CUSFTA) (Romalis, 2007). CUSFTA Agreement was signed 1988 and went into effect in year 1989. The move to bring in Mexico was much more controversial due to when in 1982 Mexico faced a debt crisis problem, during which time the country's foreign debt exceeded their ability to pay it back. While NAFTA is not a sophisticated integration like the European Union, it includes provisions that go beyond mere elimination of tariffs and quantitative trade restrictions, including disciplines on the regulation of investment, transportation and financial services, intellectual property, government purchasing, competition policy, and the temporary entry of business persons (Hufbauer and Schott, 1993). While implementing tariff removal mechanisms, the NAFTA agreement significantly increased trade between Canada, Mexico, and USA. An expansion of NAFTA trade stimulated the export performance of vital industries like agriculture, automotive, and services - health care and financial services. According to Novalinkmx (2018) foreign direct investment tripled. U.S. businesses invested for \$452 billion in Mexico and Canada. On the other hand, companies in Mexico and Canada invested \$240.2 billion in the United States that helped U.S. manufacturing, insurance, and banking companies. Another positive effect was stronger growth which has provided more job opportunities and U.S. exports to the other two countries led to almost 5 million new American jobs. In NAFTA's first four years, manufacturers created 800,000 jobs. Moreover, since the implementation of NAFTA agreement, prices were lowered.

U.S. oil imports from Mexico cost less as there was elimination of tariffs, which reduced America's reliance on oil from the Middle East. Lower prices of oil reduced gas prices which reflected on transportation cost. As a result, food industry reacted with lower prices. NAFTA's impact on trade at the product level can be clarified on the example of Mexico. The first of these events is Mexico's unilateral trade liberalization that began in 1986. In general equilibrium, import liberalization also promotes exports. Mexico's imports and exports therefore began growing prior to NAFTA. Mexico's share of US imports has increased most rapidly in commodities for which it has been given the greatest increase in tariff preference (Romalis, 2007). Nowadays, political sphere coming mostly from USA have shaken up relations between NAFTA member states which has already impacted on worse diplomatical relations. According to previously stated facts, the main scientific hypothesis of the research was made, namely, that it is possible to indicate international trade performance of NAFTA member states using relevant international competitiveness indicators. The basic objective of conducted research is to analyze international competitiveness, mainly export competitiveness and estimate international trade performance of the NAFTA Member countries, and to describe activities which could represent benefits for increased international trade competitiveness of NAFTA countries. Research contains five systematically interconnected parts. After the Introduction, the second part of the research presents methodology. The third part shows analytical framework and results of international trade and international competitiveness of NAFTA countries. The final part of research comprises proposals, recommendations and conclusions.

## 2. METHODOLOGY

Scientific approach is based on results of several indicators that indicate the level of international trade competitiveness of the NAFTA countries. The aforementioned indicators, which have been frequently used in contemporary economic research, evaluate economy's structural strengths and weaknesses *via* the composition of international trade flows (Bezić and Galović, 2013). In other words, these indicators address the question of trade specialization and performance in international markets. The aim of implemented methodology also shows the importance of the foreign market for a country and what degree of domestic demand is satisfied by imports. Moreover, the most commonly used indicators, indices, and ratios that are to assess trade patterns, characteristics, and changes in them have been observed. Besides elementary and well-known indicators, this research uses basic indicators that are suggested by OECD Statistical Database (2018) and World Bank (2018). These indicators were implemented in previous studies (Bezić and Galović, 2013; Kandžija et.al, 2014, Bezić and Galović, 2014, Galović et al. 2017) of other European manufacturing sectors which have provided realistic, objective results of international trade performance. Definitions of competitiveness provided by the Organization for Economic Cooperation and Development (OECD) and the Department of Trade and Industry (DTI) stress out the relevance of technological factors in achieving competitiveness. The Department of Trade and Industry (DTI, 1994) defines a company's competitiveness as an ability to produce certain goods and services, at the right time and price. The definition of the Organization for Economic Cooperation and Development from the micro aspect, includes competitiveness that refers to the company's ability to compete, maximize the profit and to achieve growth based on costs and prices by using technology, quality improvement and efficiency maximization of its products. There are numerous papers that measure relation between competitiveness and technological abilities. Scientists like Lall (2001) and Wignaraja (2003) and institutions like the Organization for Economic Cooperation and Development (OECD) have confronted attitudes of other scientists who are trying to define competitiveness only from the aspect of price factors by emphasizing non-price factors, like technology. The discussion has led towards the revision of traditional theories in the framework of intricacies involving competitiveness.



Some analyses of factors influencing the success or failure of efforts to promote industrialization and growth conclude that a growing level of intra-industry trade plays an important positive role (World Bank, 2018). Intra-industry exchange yields extra gains from international trade over and above those associated with comparative advantage because it allows a country to take advantage of larger markets. Intra-industry trade (IITR) represents the value of total trade remaining after subtraction of the absolute value of net exports or imports of a country. For comparison between countries and industries, the measures are expressed as a percentage of each industry's combined exports and imports. The index varies between 0 and 100. It represents the similarity between imported and exported products. The closer the value to 100 the more the products which are imported and exported belong to the same industry. If a country exports and imports roughly equal quantities of a certain product, the index value is high. Whereas if trade is mainly one-way (whether exporting or importing), the index value is low. The equation for the said indicator is shown below.

$$(1) \quad \text{IITR}_i = 1 - \left( 1 - \frac{|expo_i - impo_i|}{expo_i + impo_i} \right) \times 100$$

wherein:

$expo_i$  - export activity of sector “ $i$ ”

$impo_i$  - import activity of sector “ $i$ ”

Next indicator used is the trade balance or balance of trade (TBAL). It is the difference between the value of all goods and services a country exports and the goods and services a country imports. Therefore, this indicator is calculated in real numbers of national currencies and highlights the trade pattern of each industry. Trade balance is one of the macroeconomic indicators which are used to gauge the competitiveness of a sector at national level. When country's exports exceed imports it is said that it has a positive trade balance or trade surplus. When its imports exceed exports, it is said that the country has a negative trade balance or trade deficit. TBAL is calculated using the following formula:

$$(2) \quad \text{TBAL}_i = expo_i - impo_i$$

wherein:

$expo_i$  - export activity of sector “ $i$ ”

$impo_i$  - import activity of sector “ $i$ ”

Another simple indicator used within this paper is the export-import ratio (EXIM) which indicates the ratio of export and import shown in percentage. It is calculated as export over imports, multiplied by a hundred. In order to calculate this indicator, the formula used is:

$$(3) \quad \text{EXIM}_i = \frac{expo_i}{impo_i} \times 100$$

wherein:

$expo_i$  - export activity of sector “ $i$ ”

$impo_i$  - import activity of sector “ $i$ ”

Furthermore, the trade openness indicator (TOI) is the ratio of trade over a country's GDP. The GDP of NAFTA Member countries is presented following by the trade openness indicator. The calculation is made by dividing the sum of exports and imports of a country with its GDP which

is the value of all final goods and services in an economy during a given period. The higher the index of trade openness, the larger the influence of trade on domestic activities, and the stronger that country's economy.

The formula used is as follows:

$$(4) \quad TOI_i = \frac{expo_i + impo_i}{GDP}$$

wherein:

$expo_i$  - export activity of sector “i”

$impo_i$  - import activity of sector “i”

$GDP$  - a country's gross domestic product

Finally, the indicator called export as a share of GDP (EGDP) was used. It shows the amount of exports in a country's GDP and it is calculated as a country's total exports over its GDP. If the percentage is high it means that the GDP of a country is constituted of a lot of exports. The equation for this indicator is presented on the following page.

$$(5) \quad EGDP_i = \frac{expo}{GDP}$$

wherein:

$expo$  – total export activity of a country

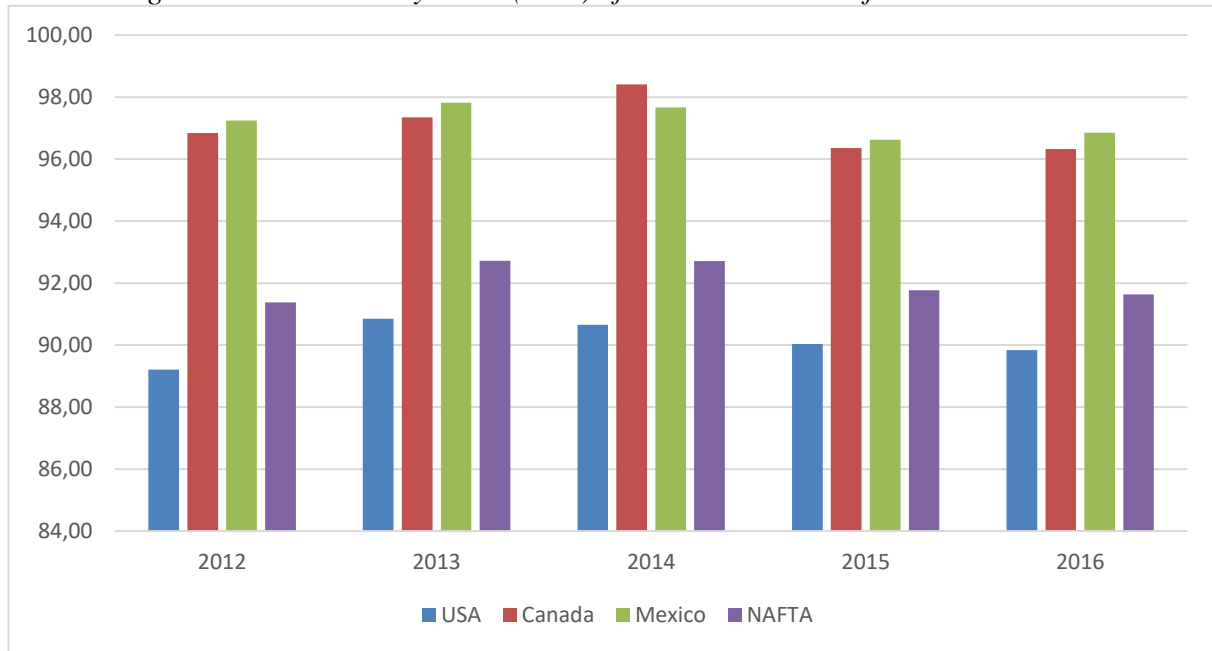
$GDP$  - a country's gross domestic product

### 3. RESULTS

Research analysis includes implementation of five trade indicators. Moreover, authors used export-import ratio, export as share of GDP, trade balance, intra-industry trade and trade openness indicators. Observed period is from year 2012 to 2016. These indicators measure export competitiveness and international trade performance of USA, Canada, Mexico and NAFTA in total. The data is extracted from UNCTADstat (2018) and detailed results can be consulted within appendixes of this research.

*Figure following on the next page*

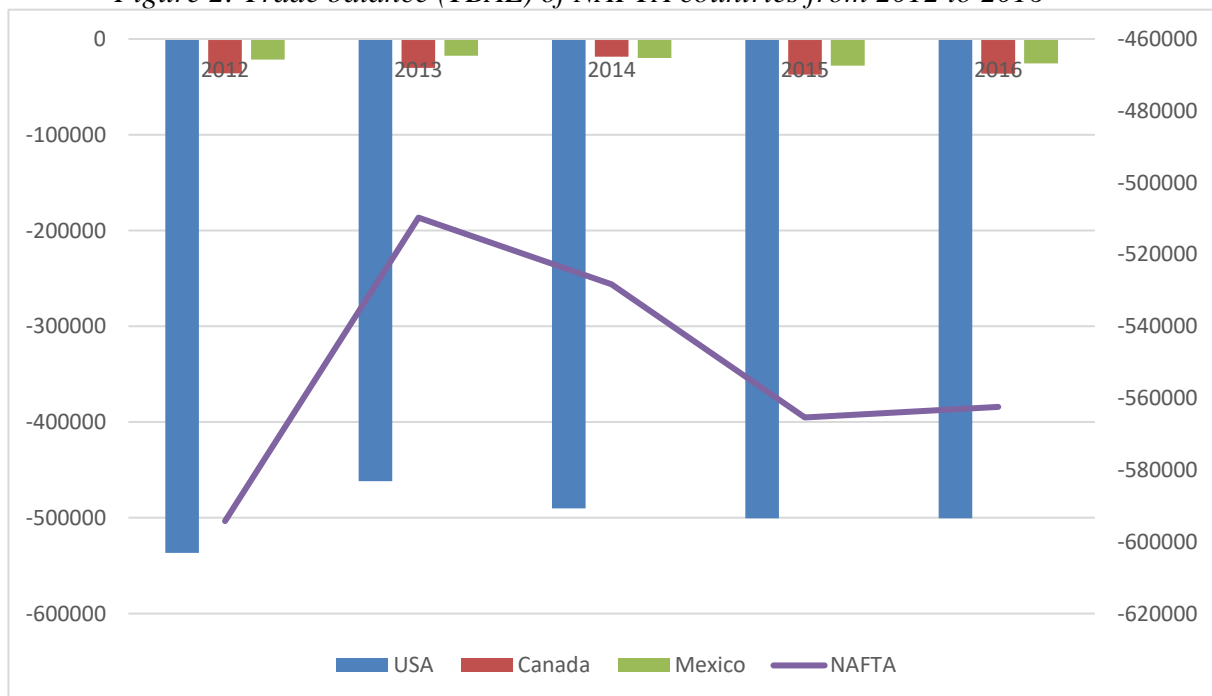
*Figure 1: Intra-industry trade (IITR) of NAFTA countries from 2012 to 2016*



*Data source: UNCTADstata, <http://unctadstat.unctad.org>, 2018*

In case of NAFTA it can be concluded that NAFTA trade block never went below 91% within period 2012-2016. However, it peaked at 93% during 2013 and 2014, and being its lowest at 91% in 2012. The average result of IITR indicator for all 5 years was 92%. Canada and Mexico represent a group of countries which exports and imports have roughly equal quantities. USA as a country tends to import more than it exports. This statement makes sense because USA is number one importer in the whole world. It can be concluded that NAFTA as a trade block imports and exports almost the same quantities of products. Previous results can be justified within following Figure 2 which shows trade balance of NAFTA countries.

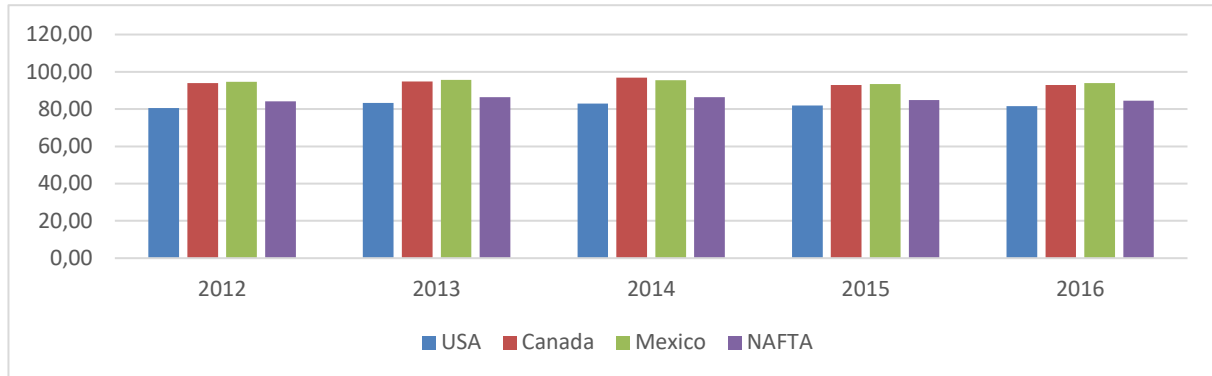
*Figure 2: Trade balance (TBAL) of NAFTA countries from 2012 to 2016*



*Data source: UNCTADstata, <http://unctadstat.unctad.org>, 2018*

Figure 2 indicates NAFTA trade deficit which was recorded for all member states including total value of NAFTA countries. The biggest trade deficit was recorded in case of USA which is significantly bigger than trade deficit of Mexico and Canada. This trend impacted on the overall trade balance of NAFTA member countries. The highest level of NAFTA trade deficit was recorded in year 2012 close to -600000 million US dollars and the lowest deficit in year 2013 where NAFTA trade balance was around -510000 million dollars. Trade Balance in the following years wasn't as volatile as between 2012 and 2013. Next Figure 3 shows the share of exports in imports of NAFTA member countries.

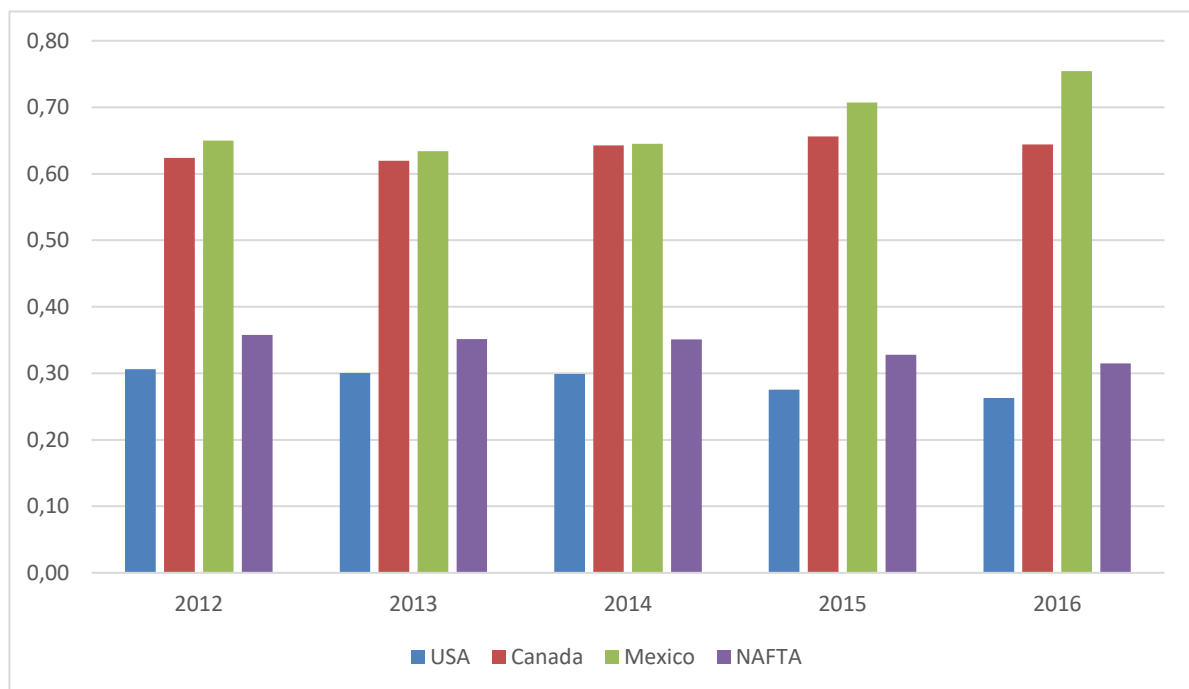
*Figure 3: Export-import ratio (EXIM) of NAFTA countries from 2012 to 2016*



*Data source: UNCTADstata, <http://unctadstat.unctad.org>, 2018*

The highest level of export import ratio was recorded for Canada. Mexico ranks second and USA third. It can be stated that export-import values of Canada and Mexico are above NAFTA average. Since USA is considered as import oriented country, it is positioned below NAFTA export-import average. NAFTA export-import trend is not considerably volatile. From year 2012 to 2014 NAFTA exports grew more than its imports but from year 2014 to 2016 NAFTA faced with decrease of exports in total imports.

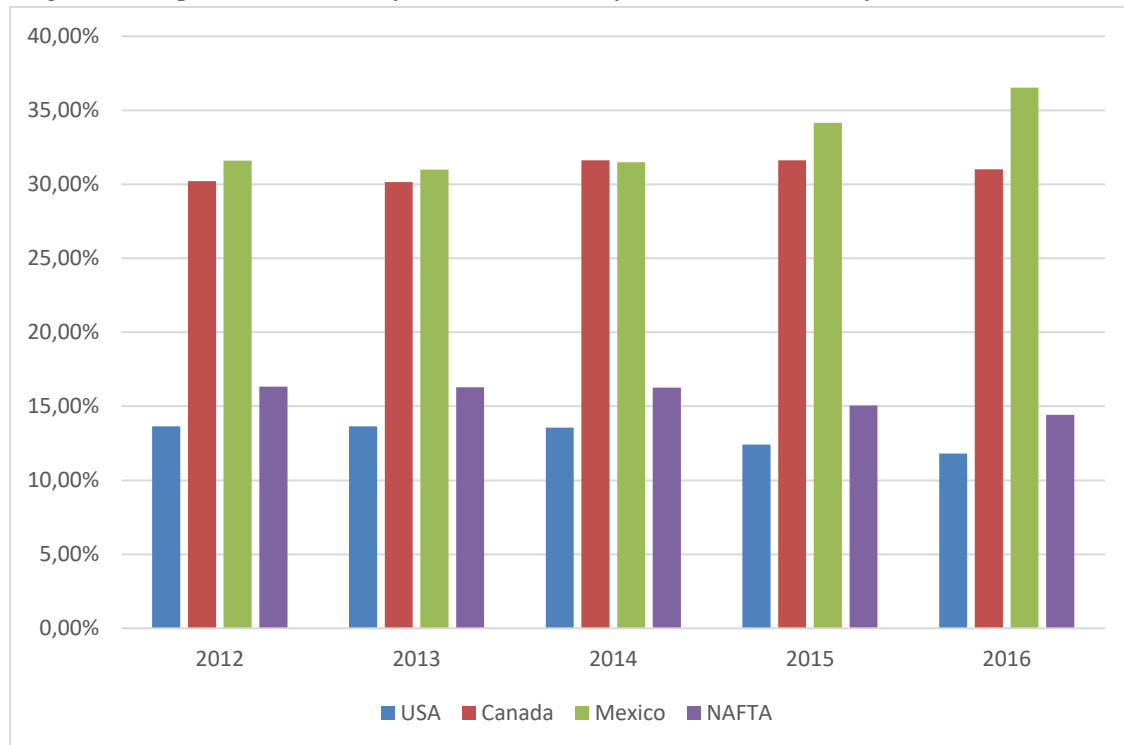
*Figure 4: Trade openness indicator (TOI) of NAFTA countries from 2012 to 2016*



*Data source: UNCTADstata, <http://unctadstat.unctad.org>, 2018*

Figure 4 illustrates trade openness of NAFTA countries which proved to be very volatile through observed period. The largest influence of trade on domestic activities is recorded in case of Mexico. The Mexican growth of trade openness is on higher level than in case of Canada. Although US GDP is significantly higher than GDP of Canada or Mexico, the value of trade openness indicator is on lower level with the existence of negative trend.

*Figure 5: Export as a share of GDP (EGDP) of NAFTA countries from 2012 to 2016*



*Data source: UNCTADstata, <http://unctadstat.unctad.org>, 2018*

Results from Figure 5 confirm results from previous Figures. Mexico and Canada have recorded the biggest share of export in GDP. Their share twice bigger than NAFTA average within observed period. From NAFTA perspective, from year 2012 until 2014 it had a share of around 16.3 % (particularly, 16,33% in 2012, 16,29% in 2013, 16,26% in 2014). In 2015 and 2016, there is a decline of approximately 1 and 1,5% because of the lower commodity prices. USA proved to be NAFTA country with smallest share of exports in GDP.

#### 4. CONCLUSION

The North American Free Trade Agreement created the world's largest free trade agreement which perspective is to link 450 million people in all of three countries and to generate 20 trillion dollars of gross domestic product annually. Results of research proved the main scientific hypothesis of the research. In another word, international trade performance of NAFTA member states using relevant international competitiveness indicators was measured and confirmed. Each trade block has its advantages and limitations. Similar situation can be clearly seen in case of NAFTA. From the export competitiveness perspective, Mexico and Canada absorbed more advantages than USA. Nevertheless, there were advantages which were utilized by U.S agribusinesses, manufacturing companies which used less costly labor force in Mexico and American consumers. From analytical point of view, trade indicators are characterized by stable constant trend except Trade Balance and Trade Openness indicators which proved to be more volatile for NAFTA Member states. However, Intra-Industry Trade has higher values which means that NAFTA imports and exports are roughly equal. In order to reach higher level of

export competitiveness, NAFTA should eliminate barriers which boost economic growth in USA, Mexico and Canada. This would increase investment opportunities and create the new jobs. Important perspective of the Agreement is to provide adequate and effective protection and enforcement of intellectual property rights, also creating effective procedures for the implementation and application of the Agreement for its joint administration. Last but not least, it is important to establish a framework for further cooperation.

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## APPENDIX

### Appendix 1: Intra-Industry Trade

IITR					
	2012	2013	2014	2015	2016
USA	89,21	90,85	90,65	90,04	89,84
Canada	96,84	97,35	98,41	96,35	96,32
Mexico	97,24	97,83	97,66	96,63	96,85
NAFTA	91,38	92,72	92,71	91,77	91,63

### Appendix 2: Trade Balance

TBAL					
	2012	2013	2014	2015	2016
USA	-536772	-461877	-490175	-500362	-500567
Canada	-35929	-30293	-18291	-37176	-36251
Mexico	-21533	-17569	-19830	-27887	-25625
NAFTA	-594234	-509739	-528296	-565425	-562443

### Appendix 3: Export-import ratio

EXIM					
	2012	2013	2014	2015	2016
USA	80,52	83,24	82,90	81,88	81,55
Canada	93,88	94,83	96,87	92,96	92,90
Mexico	94,63	95,74	95,43	93,48	93,89
NAFTA	84,13	86,42	86,40	84,79	84,56

### Appendix 4: Trade openness indicator

TOI					
	2012	2013	2014	2015	2016
USA	0,31	0,30	0,30	0,28	0,26
Canada	0,62	0,62	0,64	0,66	0,64
Mexico	0,65	0,63	0,65	0,71	0,75
NAFTA	0,36	0,35	0,35	0,33	0,32

### Appendix 5: Export as a share of GDP

EGDP					
	2012	2013	2014	2015	2016
USA	13,65%	13,66%	13,56%	12,41%	11,81%
Canada	30,21%	30,16%	31,62%	31,62%	31,01%
Mexico	31,60%	31,00%	31,50%	34,16%	36,54%
NAFTA	16,33%	16,29%	16,27%	15,05%	14,44%

## USE OF CONSUMPTION INDICATORS IN RESEARCH INTO SOCIO-ECONOMIC DEVELOPMENT ON AN EXAMPLE OF POLAND

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### ABSTRACT

*The issue of measuring socio-economic development is an important and current focus of interest for researchers representing various scientific disciplines, including economics. Systematic monitoring of changes in the area of social and economic life of contemporary societies is one of the most important tasks for economists. In particular, this remark concerns countries that have undergone transformation, integration and globalization changes, including Poland. The monitoring of changes in the individual elements that fit into the broadly understood socio-economic development is used to verify the basic objectives of changes related to the improvement of the standard of living of people, and also constitutes an important premise for conducting socio-economic policy. The analysis of consumption indicators in Poland, beginning with the accession to European Union, confirms the improvement of standard of living, and thus the progressing socio-economic development of the country. From the value-related point of view, the consumption was growing real each year, but the pace of this increase was diversified. The positive changes in the structure of individual consumption in Poland could be observed as well. They were emphasized in the decrease of food expenditures in general expenditures, while the free choice expenditures share was increased.*

**Keywords:** *consumption, consumption expenditure, consumption indicators, Poland, socio-economic development*

### 1. INTRODUCTION

In the research of socio-economic development, various measures are used, enabling, among others, description and assessment of the condition of the entire economy and its sectors, assessment of the effects of market actors' operations and monitoring of trends in various areas of social and economic life, in temporal and spatial cross-sections. It should be emphasized, however, that from the point of view of consumption entities, socio-economic development is manifested first of all by improving the living conditions of the population, and the basic tools of its description and assessment are consumption indicators. Their use ensures large measurement possibilities, but this measurement requires a precise selection of content and the scale of analyses. Analyses using consumption indicators can be conducted on a micro and macroeconomic scale. Each time the selection of specific measures should be dictated by substantive and formal-statistical premises. Particular methodological solutions concerning the use of consumption indicators as measures of socio-economic development underwent various phases of growth and decline of researchers' interest. Over the last two decades, however, significant progress has been made in studying this phenomenon using consumption measures. There was a visible improvement in the number of sources of information, accuracy of measurements and general knowledge about various elements of the living conditions of the population and their determinants. Together, this justifies the use of consumption measures to describe and assess socio-economic development.

### 2. THE CHOSEN SOCIO-ECONOMIC DEVELOPMENT MEASURES – PROBLEM OVERVIEW

The notion of socio-economic development means favorable quantitative, qualitative and structural long-term changes occurring in the economy and society of a given country (UNDP,



2012, p. 19). It denotes as well the general developmental tendency of a country, region or other territorial unit in the sphere of all economic, social and cultural activities and the relations: socio-productive and political and constitutional (Kupiec, 1993, p.13). The measurement of socio-economic development does not belong to simple tasks, because many different areas, events, objects and phenomena have to be researched. By their very nature, some of them possess aspects difficult to measure or even non-measurable ones, and examining the interrelations between them is often of indirect or postponed character. The difficulties in measurement result as well from the limited supply of statistical information, meaning the availability of information sources and the arbitrary decisions of a researcher connected with incorporating to research particular issues or their omission. As a result of measurement the specific numbers are obtained, they take the form of measures or indicators. Some of the researchers use those terms interchangeably. However, it is worth noticing, that the measure fulfills the direct informative function, because it informs clearly what it relates to. Whereas, the indicator performs an indirect function and it creates the relation between the researched issue and the general background. Both of them express the changes in various areas of economy functioning in time and space sections. They enable the evaluation of, among others, the effectiveness of conducted socio-economic country policy and the ability of entities to adjust to new conditions on the market. In the present study both terms are used interchangeably. Among scientists and researchers, there is a common consent that methodical and theoretical approach to research concerning socio-economic development may be analyzed from three different points of view: economic, social and subjective (Sirgy, Michalos, Ferriss, Easterlin, Patrick, Pavot, 2006, p. 343). In the economic approach, the economic utility maximization criterion is usually taken into consideration (Dasgupta, 2001, p. 149). The enormous importance is attached to the income and its derivatives (e.g.: consumption expenses), which enable the measurement of researched phenomenon in numerical category. Unfortunately, this kind of approach presents only partial view on economic reality. It does not take into consideration such issues as: natural environment, national state of health, education. In the social approach, the wide range of social indicators is used. Retaining the impartial character of the measurement, the gaps are filled in those life dimensions which are not researched with the use of economic indicators (e.g.: the indicators of participation in culture). The social indicators are used mostly to describe and monitor the social tendencies and to identify problems, establishing priorities and to evaluate the socio-economic policy of the countries (Noll, 2004, p.151). In the subjective approach, the research over socio-economic development is related to the use of subjective indicators reflected in the form of subjective opinions of the respondents (e.g.: the current indicator of consumer trust). They provide detailed and reliable information concerning those aspects of life which cannot be researched with the use of previously mentioned measures (Grzega, 2012, pp. 77-78). The measures of socio-economic development can be classified according to different criteria. Taking into consideration the tradition of use (the time and commonness of use) of the given measure, the traditional and “alternative” measures can be distinguished. The traditional measures are used for years and they are accepted by the researchers as the classic, conventional, standard or in other words customary measures with objective or subjective character. Whereas “alternative” measures are treated as the complementary (opposite sometimes) in the relation to traditional and officially accepted measures. Mostly, they are based on non-value-related categories (e.g.: the indicators of height and body weight, the indicators of incidence of chosen diseases, the indicators of energy use) (Grzega, 2015, pp. 80-83). The traditional measures divide into objective and subjective categories. The objective measures can take the form of value-related measures, i.e.: those reflected in monetary units (e.g.: in dollars) and the form of quantitative measures, those reflected in natural units (e.g.: in years). The subjective measures express the people’s opinions connected with the chosen issues of socio-economic development, including

the level of fulfillment of people's needs. In order to define it, various types of direct research are used. In literature and in the economic practice, for years, there are discussions on the impartial and subjective indicators range of use in the research concerning the chosen aspects of socio-economic life. Essentially, the objective approach concentrates on the measures of so called “hard facts” (e.g. the national per capita income), and the subjective approach favors “soft facts” (e.g.: the satisfaction out of the income situation in own household). Taking into consideration the scope of researched economic reality, the socio-economic development measures can be divided as follows:

- partial measures, i.e.: unit, specialist or detailed measures – used to evaluate one, narrow element of researched reality (e.g.: the percentage of households with computers with the Internet access),
- synthetic measures – used to evaluate the economic reality or general conditions of society's life areas greater than individual area (e.g.: HDI- Human Development Index). In this group, global measures can be distinguished additionally. They are either single digit indicators constituting the result of different social life dimensions, which cannot be separated and their influence on the researched area cannot be defined (e.g.: GDP per capita or the indicator of the average life span of men and women) or composite indicators, meaning the measures used to evaluate the socio-economic development, which are obtained by empirical adding certain number of variables together -economic, social and other (e.g.: the indicator calculated according to Geneva method).

The objective synthetic indicators can be divided additionally for:

- indicators based on natural units (e.g.: Geneva method),
- indicators based on value-related units (e.g.: GDP per capita),
- mixed indicators (e.g.: HDI).

In the group of value-related indicators it can be distinguished as well:

- the basic indicators of national account systems, e.g.: gross domestic product (GDP), gross national income (GNI), the indicator of global consumption rate and the indicator of extended consumption,
- the modified measures of national account systems, e.g.: Measure of Economic Welfare MEW, Net National Welfare NNW, Index of the Economic Aspects Welfare EAW, Index of Sustainable Economic Welfare ISEW (Grzega, 2015, pp.80-83).

Concentrating on the basic indicators of national account systems it is worth noticing that GDP and GNI per capita are traditionally used measures, which initiate the analyses concerning the level of economic development of a given country. Treated as the prosperity and economic measures they are based on material wealth. Their basic advantages are related to the low level of complexity of calculations and the impartiality of measurement (Gorobievski, Nădrag, 2011, pp. 640-649). However, the above mentioned measures reflect only the mean values, which present the internal structure and disproportion between particular social groups. They do not take into consideration such aspects as e.g.: housing conditions, natural environment, market supply, the value of free time, leisure and the size and quality of services connected with following areas: health care, education, cultural services and others. The criticism of GDP treated as a measure of socio-economic development is expressed by many recognized and respected economists, including Nobel Prize winners. The particularly significant contribution was made by: Kuznets (1941), Hicks (1948), Galbraith (1958), Samuelson (1961), Mishan (1967), Nordhaus and Tobin (1972), Easterlin (1974), Hueting (1974), Hirsch (1976), Sen (1976), Scitovsky (1976), Daly (1977), Frank (1985, 2004), Hartwick (1990), Tinbergen and Hueting (1992), Arrow et al. (1995), Weitzman and Lofgren (1997), Dasgupta and Maler

(2000), Dasgupta (2001), Ng (2003), Kahneman, Krueger, Schkade, Schwarz, Stone (2004). In their studies, they touched upon following issues: the principles of proper GDP calculation, the lexicographic preferences connected with fulfilling the basic human needs, the empirical research on happiness, the distribution of income, the averaged character of the measure, the accounting for non-market consumption and informal income, the failure to take into account the external environmental factors and exhaustion of natural reserves (Bergh, 2009, pp. 117-135; Dasgupta, Mäler, 2000, pp. 69-93; Kahneman, Krueger, Schkade, Schwarz, Stone, 2004, pp. 429-434). Taking into consideration the above, the theoretical arguments, connected with the use of income or consumption in the research on socio-economic development, are almost always in consumption's favor. The contemporary research, conducted on the basis of the use of means of consumption, clearly indicate to significant and constantly growing role of consumption in the research that is discussed (Yin Fah, 2010, pp. 145-150; Meyer, Sullivan, 2003, pp. 33-35).

### **3. THE BASIC CONSUMPTION INDICATORS – THEORETICAL APPROACH**

The research on consumption serving as an evaluation of socio-economic development can be conducted with relation to following scales:

- macro scale – concerning the total population of a given country or other territorial community or the whole sector of households (e.g.: passenger cars' possession in household in %, in total households),
- meso scale – concerning the chosen socio-professional groups (e.g.: level of income left at the disposal of retirees),
- micro scale – concerning individual consumers.

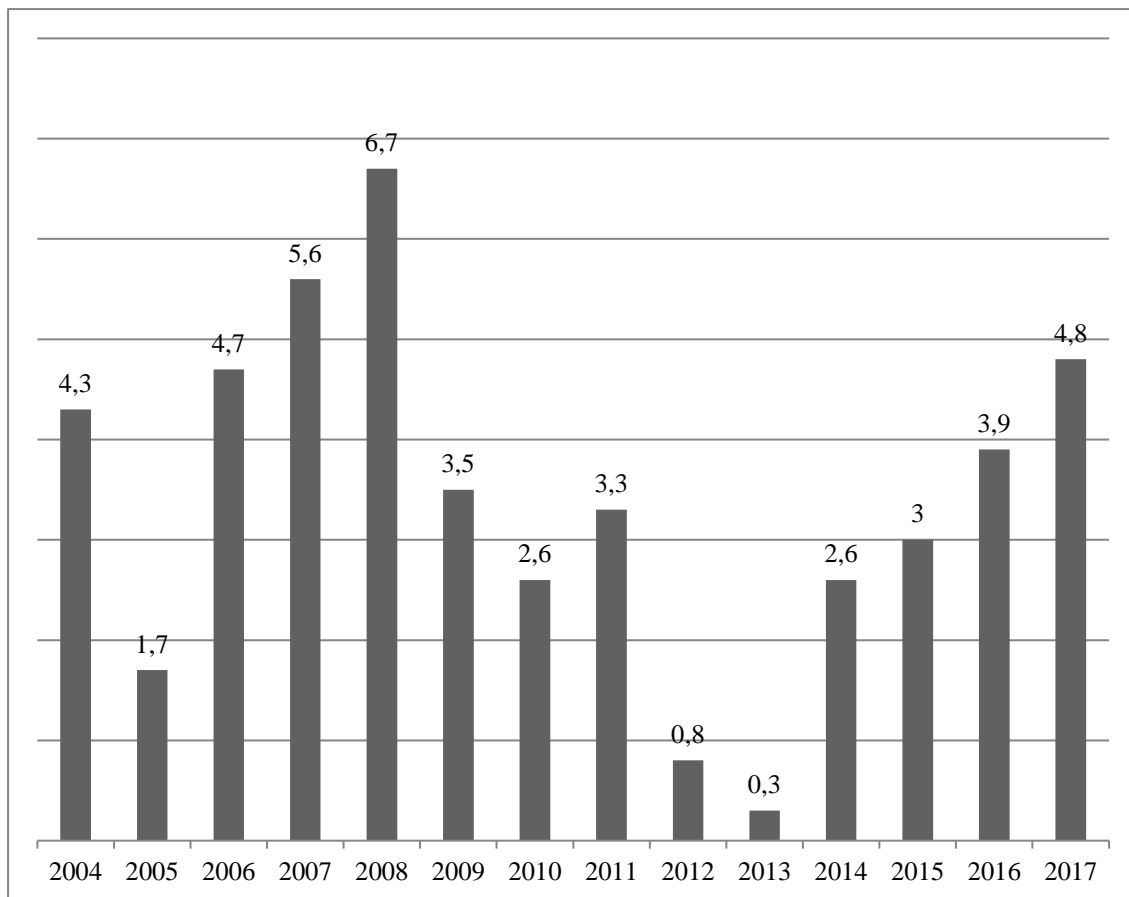
Taking into consideration the above, the research with the use of consumption indicators may be conducted on the basis of various source data. In the first case, the significant importance is attached to macroeconomic data achieved from national account systems. In the research, on the level of meso scale, the special significance is attached to the budgets of households. Whereas, in micro scale, the most significant is the research gathering the consumers' opinions on the subject of economic condition of their households or on other issues relating to area of socio-economic research. One of the basic consumption indicators characterizing the level of socio-economic development of a country is an indicator of global consumption. It depicts above all, the material level of population's life. As regards the difficulty to bring to a common denominator the size of consumption of various goods and services, the global consumption indicator is expressed in monetary value. The expenses of a household are mostly spend on consumption goods and services, meaning: the purchase of food, alcoholic beverages, non-food-related goods and services. The very own essence of the discussed indicator depends on the accepted system of prices and the range of consumption. This indicator may include the value of goods and services financed from the disposable income of households and/or the value of goods and services financed from public sources (e.g.: the educational services, the health care services). The basic objection, as stated towards this indicator, is the difficulty of making the proper estimation of services provided free of charge and partially for a payment. This indicator does not take into account the transfer of the savings, the level of stocks, durable consumption means of households and it does not inform about the structure of consumed goods and services. Some solution to that is using the extended consumption indicator which includes additionally the value of household work expressed in money. Still, in this indicator, actions taken into consideration are only those which bring positive result in the range of needs fulfillment level e.g.: redecoration, cleaning, sewing. The problem of estimation of this kind of work did not meet the commonly accepted solution. It is difficult to evaluate the work done by members of households using the wages of e.g.: a painter or a cleaning lady.

In a simplistic form, there were attempts to evaluate all of the household activities according to the mean wage of worker with low qualifications (Andrycz, 1995, p.12) but they did not find the application in a long term. In the analyses of socio-economic development, the indicators of level, dynamics and the structure of consumption expenses in the nominal and real approach (in macro and meso scales), are used most frequently. They enable knowing the pace and directions of income dispersion of available income of households for satisfying various groups of needs. The expenditures, as a derivative of income, their level, structure and changes in time can give relatively actual image of state and development of the economy. The thorough analysis creates possibilities to make comparisons in time and space as well. One of the oldest measures of consumption, used to evaluate the level of whole populations and some households development, is food indicator. It expresses the share of food expenditures in general expenditures and it is treated as one of the leading measures of society wealth and the societies life level. E. Engel noticed over 150 years ago that the size of an income defines the society material life level and it models the food expenditures and other goods. According to his 1<sup>st</sup> law, the higher the income, the lower the share of food expenditures. The low value of food indicator means that relatively small part of the income is designated for food. It proves simultaneously that the society is wealthy, and conversely – the high value of food indicator, means substantial share of income allocated for food and low level of society wealth (Grzega, 2012, p. 170). Therefore, analyzing this measure in time – the decreasing share of the food expenditures in general expenditures shows that there is improvement in society wealth and in the economic development of a given country. Another measure, which depicts the level of economic development of societies is the indicator of free choice expenditures, counted as the share of free choice expenditures in general expenditures. The free choice expenditures are the expenditures devoted to fulfilling more than basic needs of households. Those expenditures are not necessary to function normally, and the resignation from them does not result in any effects on health, life or functioning in society. However, their high and still growing values show the advancing economic development. It is worth noticing, that the division of expenditures into basic and of free choice is often of arbitrary character, because it can be modified with various subgroups of expenditures. The criterion of expenditures division for basic and of free choice is always the answer to question whether the given expenditures is connected with the fulfillment of the need treated as conventionally indispensable in some socio-economic conditions. Such a division is firstly- highly subjective, which disables the possibility to compare the expenditures in particular groups, and second- impossible to conduct on the basis of public access information sources. To estimate the socio-economic development of societies, the quantitative consumption indicators are used. They are expressed in the natural units e.g.: pieces, kilos. They enable, in a relatively objective manner – because it relates to physiologists’ and other specialists’ recommendations – the estimation of the level of fulfillment of chosen need groups e.g.: food, housing, recreational and other needs. The positive quantitative and qualitative changes relating to natural consumption indicate the improvement of standard of living and as a result the socio-economic development.

#### **4. THE CHANGES IN CONSUMPTION EXPENDITURES AND IN CONSUMPTION IN POLAND**

The aim of consideration in the present part of the study is the presentation of the changes in consumption of households in Poland beginning from the moment of accession to European Union. The research material constitutes secondary information sources such as macroeconomic Statistics Poland data derived from national account systems and relating to individual consumption in household sector. The size, pace of changes and the consumption structure of the whole household sector are the primary indicators enabling the relatively objective evaluation of the level of economic development of a given society.

In Statistics Poland methodology, the household final consumption expenditure is exploited with this end in view. This category includes all of the expenses made by the household sector, which is one of six institutional sectors in the country. The remaining part is the government expenses and the expenses of non-governmental organizations for healthcare and education (GUS, 2018). It results from the data in Fig.1. that between 2004 and 2017 the positive changes in individual consumption in Polish household sector were noticed. Taking into consideration the current prices, the individual consumption from personal income increased in the researched period of time by 43.6%. The real gross disposable income in household sector increased in the same time by 43.9% (GUS, 2018).



*Figure 1: Changes in household final consumption expenditure in Poland in the years 2004-2015 (constant prices) (GUS, 2018)*

Between 2004 and 2017 the various pace of consumption increase could be noticed. The highest noticed in 2008 and the lowest in 2013. The high pace of consumption increase between 2005 and 2008 resulted from the good economic conditions in a country. The decline of pace increase visible between 2008 and 2013 was a results of economic crisis reflected in households consumption as well. It is worth noticing, that during this time most of the member European Union countries had to reduce their own expenditures and adjust them to the conditions on the national markets. However, Poland facing the crisis handled it relatively well (the decrease of consumption was not noticed even once). Years 2013-2017 brought renewed and visible improvement of the pace of individual consumption changes in household sector. It happened mainly with contribution of well and constantly improving conditions on the labor market, good consumer mood, relatively low consumption goods and services price dynamics and the increase of dynamics of gross disposable income in households. The change of pace in household consumption was accompanied by the change of its structure (Table 1.)

*Table 1: The structure of the household final consumption expenditure in Poland in the years 2004, 2008, 2012, 2015 (in % of total expenditure, current prices) (GUS, 2018)*

<b>Expenditures</b>	<b>2004</b>	<b>2008</b>	<b>2012</b>	<b>2015</b>
Food and non-alcoholic beverages	21.1	19.9	19.5	16.8
Alcoholic beverages, tobacco, narcotics	7.1	7.4	8.0	6.6
Clothing and footwear	4.8	4.0	3.8	4.9
Housing, water, electricity, gas and other fuels	21.3	21.2	22.8	21.3
Furnishings	4.3	4.3	4.3	5.1
Health	4.2	3.9	4.0	5.2
Transport	10.5	11.7	10.9	12.0
Communication	3.2	3.1	3.0	2.4
Recreation and culture	8.0	7.6	7.7	7.7
Education	1.4	1.2	1.2	1.0
Restaurants and hotels	2.9	2.8	2.8	3.7
Miscellaneous goods and services	11.2	12.0	12.0	13.3

It results from the data in Table 1 that in the analyzed period of time the share of food expenditures decreased by 4.3 percentage points. The decrease in the percentage of expenditures for communications (by 0.8 percentage point), alcoholic beverages and tobacco products (by 0.5 percentage point), education (0.4) and recreation and culture (0.3) could also be noticed. While the following expenditures areas increased: transport (by 1.5), health (by 1), apartment furnishings, household utilities and restaurants and hotels (each by 0.8) as well as the miscellaneous goods and services (by 2.1). In the case of the expenditures for housing, water, electricity, gas and other fuels and clothes and footwear the changes of their share in the general structure of expenditures did not exceed 0.1 percentage point counting from the moment of European Union accession. Undoubtedly, the most significant change stating the improvement of the standard of living of Polish society life between 2004 and 2015 was the decrease of food indicator. The systematic decrease of the value of discussed measure, year by year, indicates to slow, gradual improvement in wealth of Polish society. The similar conclusions can be made on the basis of free choice expenditures. For the purpose of the present research the following expenditures were included into this group: alcoholic beverages and tobacco goods, recreation, culture and education, restaurants and hotels and miscellaneous goods and services. The level of the free choice expenditures, expressing the level of fulfillment of higher-order needs, is diverse depending on the analyzed year. Broadly speaking, between 2004 and 2015 this indicator pointed the increase tendency in the whole household sector, where the share of free choice expenditures increased from 30.6% to 32.3%, i.e.: by 1.7 percentage point. The greatest advancement could be noticed in subsector of employers and own-account workers outside private farms in agriculture. In this case, the share of free choice expenditures increased by 3.6 percentage point. It is simultaneously subsector of households which are characterized by the highest share of free choice expenditures in the expenditures in general. The smallest difference in the increase of share of free choice expenditures was noticed in the subsector of employers and own-account workers in private farms in agriculture. It increased only by 0.5 percentage point. It is also the group which possesses the lowest share of free choice expenditures in relation to other households. As an instance, the difference in relation to in subsector of employers and own-account workers outside private farms in agriculture, equals almost 10 percentage points (GUS, 2018). The changes in value-related consumption proceeded simultaneously with the quantitative consumption which is proved by the data concerning the consumption of chosen food and non-food-related goods, expressed in natural units, calculated for 1 Polish inhabitant. It results from the data in Table 2 that between 2004 and 2016 there was a decrease in consumption of carbohydrate products, such as: bread, flour, rice, potatoes and

edible animal fats as well, further on the decreased consumption could be noticed in the following: eggs, vegetables, wines and mead and tobacco products. While the increase was noted in: meat, milk, sugar, high-proof alcoholic beverages and beer. The consumption of fruit remained steady. Those changes – in physiologists’ opinion – have double meaning, positive and negative. Broadly speaking, in the opinion of the case researchers, the decrease of carbohydrate products consumption – in general or in relation to consumption of other valuable articles e.g.: low fat meat – proves that the life level in Poland was improved (Bywalec, 2010, pp.272-273).

*Table 2: Consumption of selected consumer goods in Poland calculated per capita in the years 2004, 2008, 2012, 2016 (GUS 2009, p. 65, GUS, 2017, p. 69)*

<b>Specification</b>	<b>2004</b>	<b>2008</b>	<b>2012</b>	<b>2016</b>
Grain of 4 cereals in terms of processed products in kg	119	112	108	103
Potatoes in kg	129	118	111	97
Vegetables in kg	111	115	103	106
Fruit in kg	55	55	46	54
Meat and edible offal in kg	71.8	75.3	71.0	77.6
of which meat	67.3	71.2	67.3	73.4
Edible animal fats in kg	6.6	6.4	6.0	6.1
Cows’ milk in l	174	182	193	222
Hen eggs in units	211	205	140	145
Sugar in kg	37.6	38.4	42.5	42.3
Vodkas, liqueurs, other alcoholic beverages in terms of 100% in l	2.5	3.4	3.0	3.2
Wine and mead in l	10.6	8.2	5.9	5.8
Beer from malt in l	77.5	94.4	99.2	99.5
Cigarettes containing tobacco or mixtures of tobacco in units	1927	2091	1728	1891

Between 2004 and 2016 the significant progress in level of equipping with durable consumer goods in Poland was visible. The improvement was noted in the level of equipping with the basic household appliances and in the luxury equipment. Possessing a private car became popularized, as well as having modern communication and recreation appliances, household appliances and others. The state of possession was improving year by year in quantitative and qualitative sense as well. Each year Polish people purchased more and more multifunctional goods, stylized, individual, versatile, esthetic, eco-products and others. The improvement of the condition of possessing the durable consumer products is a positive phenomenon. It proves the existence of consumption modernization and simultaneously it gives expression to better fulfillment of consumption needs in Poland, confirming the improvement in life conditions as well. (Grzega, 2017, pp. 190-193).

## 5. CONCLUSION

In the course of discussion and conclusions directing to identification of the results of crisis, globalization, integration, economies transformation and other current problems of economic nature, there was a constantly growing need to measure the changing economic reality with the use of diverse range of measures treating the economic development in a complex manner which is in accordance with leading assumptions of sustainable development. Nowadays, it is frequently emphasized that the economic measures announced by public statistics, showing e.g.: economic growth, do not meet the acceptance in many of social groups and do not fully reflect the economic development, neither social development.

The official statistics are accompanied for many years by the same social skepticism. However, those are measures possessing rich methodological basis, long research tradition, the continuity of realization, simplicity, the reliability of calculations and impartiality. The consumption indicators can be included into this group. They may be based on the national account systems or on the household budget surveys. In the present study, the first source was taken into account. The consumption indicators as the measures of economic development describe the changes in this development relatively well. Especially, when they are analyzed in long-term time series. These measures are relatively simple to use and easy to interpret. Analyzing the changes in time with their use, the improvement of value each year indicates by itself to the development. However, it needs to be kept in mind that these are the measures describing the material dimension of functioning of consumption entities. By mentioning the material dimension of managing, we could think of various categories describing relations between needs and quantity-related consumption, including prosperity, the standard of living and the living conditions. A difficulty encountered, while using the consumption measures, to evaluate economic development is connected with the fact that there is no fixed limit of needs fulfilment, especially maximum limit. Frequently, there are missing some reliable points of reference. What is more, it is difficult to relate, in a direct and measurable way, the changes in consumption to economic development. Some of the conclusions are made on the basis of logical factors and not precise calculations. It is an effect of a situation where not all objects can be brought to a common denominator, which is e.g.: currency, piece or kilogram. Despite all of these reservations, it was accepted in the present study that the measure of obtained economic development is the level and structure of consumption expenditures and household consumption. Summarizing, on the basis of macroeconomic data analysis it can be stated that starting from the Polish accession to European Union, the Polish consumption developed in value-related and quantitative expression. Poland reached the level higher than this from 2004. The positive changes were observed as well in the Polish consumption structure which is proved by the decrease of food indicator value and the increase of free choice expenditures indicator value. The share of the indispensable expenditures, including food and non-alcoholic beverages, housing, water, electricity, gas and other fuels and health, decreased from 2004 level-46.6% to 43.3% in 2015 in general consumption value. The positive quantitative and qualitative changes occurred as well. They related to food consumption, the progress in equipping in durable goods and as a result – the general modernization of consumption model.

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## THE STATE CAPITALISM IN RUSSIA: NEW ECONOMIC IDEOLOGY

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### ABSTRACT

*Today an exit of the Russian economy from stagnation and its further growth and development directly depend on activity of business sector. Both economists-theorists and real businessmen speak about it. The economic science abounds with theories about importance of the liberal capitalism. However, today's realities have shown insolvency of many both microeconomic, and macroeconomic theories. For today more often political, economic and business agents unanimously declare specifics of the Russian capitalism, calling it state. The key principle of the liberal economy of "laissez-faire" has shown the insolvency. Large business concentrates huge resources, and therefore its potential is enormous. The state capitalism is the ideology which is actively criticized in foreign researches. Nevertheless, there is a question of relevance of that for Russia. The set of researches is devoted to medium and small business: the question of the importance of small and medium business constantly are taken up among science, business and political elits. However, there is also other point of view – small business in view of the existing features of the Russian reality simply can't become a "locomotive" of economy. If to pay attention to the sphere of large business, then here, frankly speaking, monopolies and oligopolies function. If to trust neoclassical economic theories, then any monopoly (as well as an oligopoly, just to a lesser extent) distorts efficiency of a market mechanism, so, reduces welfare of all contractors (both the consumer, and the state) due to redistribution of excess profits in own favor. Our research answers questions: "What business is necessary to the Russian economy? What structure of property of large business answers problems of scientific and technological development of Russia? In what measure does the state have to regulate and control large business?"*

**Keywords:** *capitalism, state capitalism, economic ideology, structure of property of large Russian business*

### 1. LITERARY REVIEW

Russian capitalism is a unique economic system because of its history as well as for its own modern conformation, the most important economic change has started with the fall of the Soviet Union, in this period, the newborn Russian Federation has started a political process that had different phases in its history. Indeed, if during Yeltsin era, Russia started a very quickly process of liberalization and privatization on national economy, with Putin era this process was in part interrupted in order to give more space to a hybrid economic form made by capitalism,

protectionism and export as a political instrument. The Yeltsin era was characterized by a great grade of liberalization and privatization in the economic field, but this process was not supported in other sector of Russian society, at first in the politic one. The concept of democracy in Western countries did not have popularity in Russia, so quickly new Russian political class and consequently Russian society, create its own concept of democracy that is not recognized in Western countries (Lindau and Cheek, 1998, pp. 295-298). One of reason because of the failure of liberalization process promoted by Yeltsin was the impossibility of the new economic class to understand the new economic system, they were not able to recognize the formula which guarantees the economic success: the maximization of profit, innovation and technological progress and first of all, economic stimulus (Ouvarovskii, 2007, pp. 4-5). This happened at first because of the recent communist past of the new Russia; people lived for three generations in a planned economy, so was the state who answered to such questions as the economic development, people had only to work. However is also true that the process of liberalization of economy has started with Mikhail Gorbachev during the spring of 1987; in this period indeed hast started the political process namely perestroika (McFaul, 2001, p. 384). After the Yeltsin era, in the Russian political scenario appeared a new person who became one of main influent politician of all World, Vladimir Putin. The liberalization process of Russian capitalism started in '90 did not work at first because it was not controlled and regulated by institutions; state sold all its national companies but almost all Russians were not prepared to this new system. So the result was that a little elite of Russian with European education and capitals were able to buy big national companies for few money; in this mode they were able to increase their power and influence so rapidly in these years. Yeltsin did not have the force to stop this close circle because his political power was limited. Vice versa, Putin started a new reform process that changed radically Russia; at first he started a negotiation of liberalization within the elite; to do it Putin at first created a stable and strong governmental reform team (Cook, 2007, pp. 145-149). So he renegotiated the process of liberalization of Yeltsin with who received a lot from it, and he started a new process of “limited” liberalization accompanied by a form of protectionism in order to defend the national production. These are the premises that generated the current state capitalism that exists in the Russian Federation.

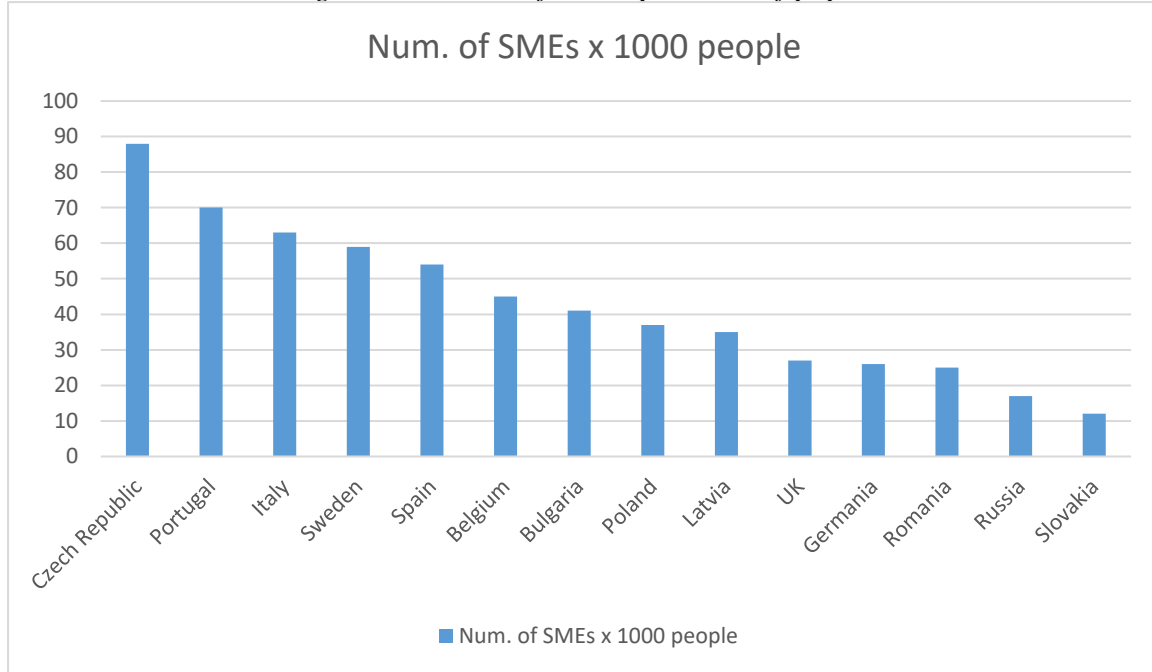
## **2. RUSSIAN CAPITALISM TODAY**

### **2.1. SME sector in the Russian Federation**

Actually Russian capitalist system as some peculiarities that characterize it than other nations. One of main important is the quantity of small, medium and big sized companies. In the Russian Federation the small-medium sized companies sector is not developed as in other countries. Looking at statistics of the European Investment Bank of November 2013, is possible to affirm that Russian small medium sector is one of the less developed in all Europe. The following figure shows number of SMEs per 1000 of population.

*Figure following on the next page*

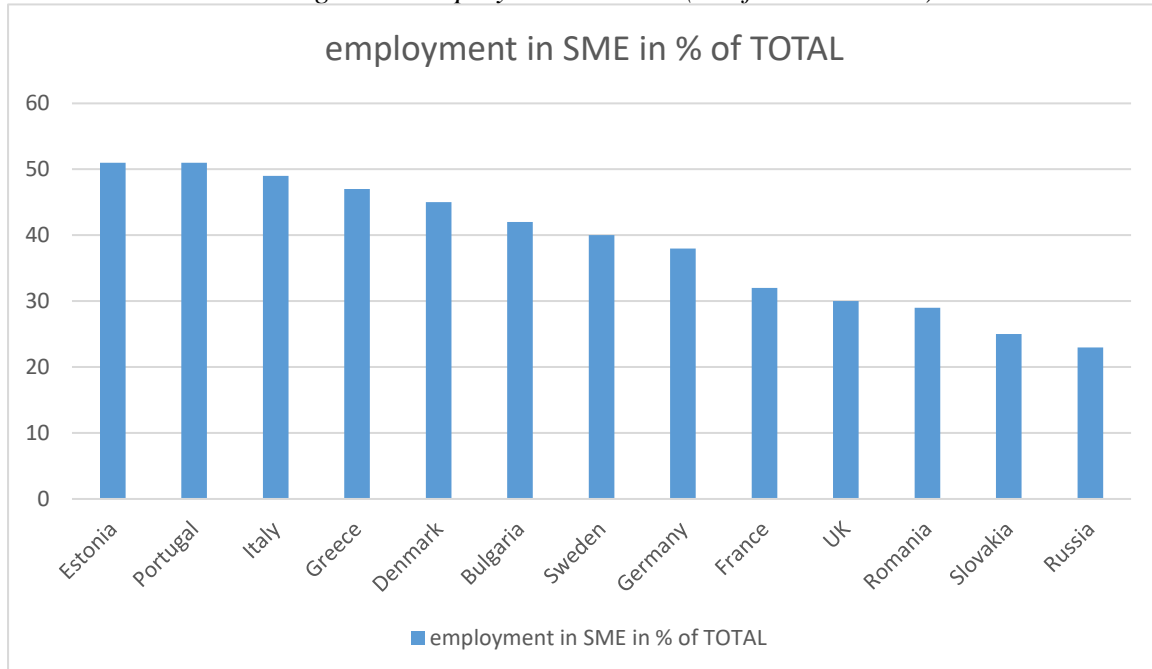
*Figure 1. Number of SMEs per 1000 of population*



*Source: European Investment Bank, 2013*

The few quantity of small-medium enterprises in Russia is proved also by another statistic: the employment in SME in percentage of total employment. The following figure will show data about 2011 in some European countries.

*Figure 2. Employment in SME (% of total amount)*



*Source: European Investment Bank, 2013*

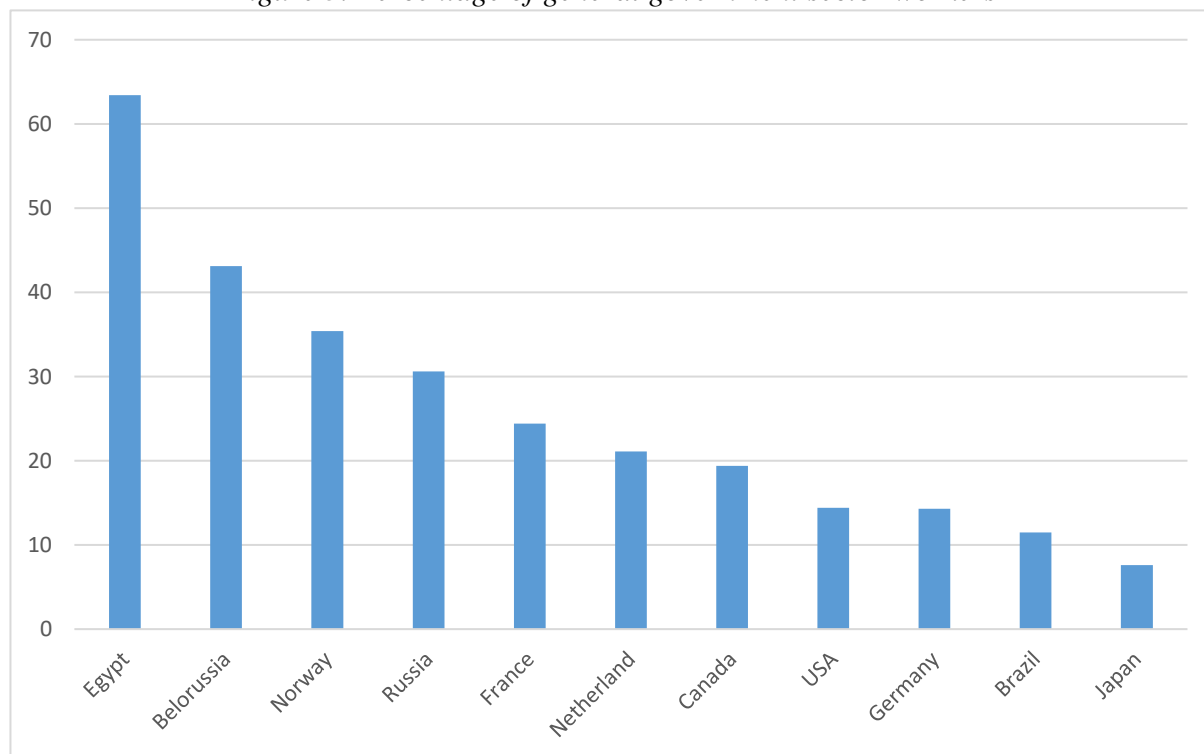
Therefore, the Russian Federation is in the last place in all Europe with 23%; even if data are of seven years ago, is important to underline that the situation in this ark of period did not improved significantly. Indeed in 2017, employment in SME in percentage of total employment in Russia was about 25%, it means only +2% in seven years (Kondryatov, 2015).

This situation is the result of the traumatic (and not so regulated) passage from planned economy to capitalism. Few big companies were able, during '90 years, to create a situation of oligopolies in different economic sectors, which today do not give the possibility to new small business to develop and conquer their market quote. Moreover this situation is favored also by a different approach that Russians have with small and medium enterprises; indeed in this country young people prefer to study in order to become an important director or manager of a big company instead to risk and try to create its own business. Probably such kind of mentality is again a result of a different historical process, indeed the collectivism of Soviet Union, as its idea of unity did not give space to people to think about “themselves” and their development; so, today Russian people may prefer to reach a governance position in a big company instead to create its own business.

## 2.2. Russian economic policy and Russian state in economy

As all nation that are having the state capitalism as economic form, Russian government assumes a prominent position in the economic life. This implies different results as for example a protectionist economic policy that does not favourite the free exchange as well as foreign investment, but at the same time it defends the national production from a process of deindustrialization of the nation as happened in Western countries. Russian government not only uses a strict control on economy in order to preserve national interests, but they also take part actively in the economic process; indeed in Russia there are a set of companies that are totally or in part or de facto national. More than fifty big companies are at least for the 51% controlled by the state, such companies that in western countries were sold by the state during '80 and '90 years, for example: Russian Post service, Aeroport of Kolzo, Aeroflot, Russian Television and Radio Broadcasting Network, Closed Joint-Stock Company "Joint-Stock Company" Alrosa " or the Russian Railways Company (Government Commission on High Technology and Innovation of RF, 2010). The following figure shows the percentage of general government sector workers in confront of total amount of workers in different nations.

*Figure 3. Percentage of general government sector workers*



*Source: RBK, 2014*

More significantly is the economic freedom index that explain the grade of economic liberty in every nation every year; this index is an idea of 1995 created by the think tank the Heritage foundation and the Wall Street Journal, actually it includes 12 freedom indexes, from property rights to financial freedom (The Heritage Foundation, 2018). The following table shows the Russian economic freedom index trend.

*Table 1. Economic freedom index of Russia*

Year	Economic Index Freedom	Year	Economic Index Freedom
2011	50.5	2015	52.1
2012	50.6	2016	50.6
2013	51.1	2017	57.1
2014	51.9	2018	58.2

*Source: The Heritage Foundation, 2018*

Is interesting to underline that since 1995, Russia had an index more than 55 only in the last two years, 2017 and 2018; it means that even if Russian government is continuing to use a protectionist economic policy, anyway it decides also to liberalize in part its national economy. Another interesting fact concern the comparison with nation that are living in a state capitalist system (as for example Russia, China or Vietnam) and other who are living with liberal capitalism like USA or Germany or UK. The actual situation is that in Russia the economic freedom index is 58.2, in China 57.8 and in Vietnam 53.1; vice versa in USA is 75.7, in Germany 74.2 and United Kingdom 78. Is clear that state capitalism is characterize by less freedom than liberal, anyway is also important to underline that in Russia, like China and Vietnam, in the last 10 years the economic freedom index is continuing to grow up. However, the investment freedom index in Russia was until 2004 50%, after that it decreased to 25%-30%; it means that the economic freedom regards more the real economy (as the industrial and agriculture sectors). The same is not for the financial economy, indeed main big Russian banks as well as Sberbank or BTV are controlled de facto by the State. However, the strict control of the state does not influence negatively another important index made by the World Bank: the doing business index. It measures how much is difficult in every nation to open a business and to make all necessary documents to can start the own activity legally; moreover it says also how government reforms modify the level of difficulty of doing business. General rank of Russia is 35<sup>th</sup> place, that is it better than some Western countries as Italy (46<sup>th</sup>), Belgium (52<sup>nd</sup>), Luxembourg (63<sup>rd</sup>) and it is also the best in the BRICS area, indeed China occupies the 78<sup>th</sup> place, South Africa 82<sup>nd</sup> place, India 100<sup>th</sup> place and Brazil 125<sup>th</sup> place (World Bank, 2018). The following table shows the doing business index of Russia divided in subcategories.

*Table 2. Doing business index of Russia of 2018*

POSITIVE FACTORS		NEGATIVE FACTORS	
Index	Place in World Ranking	Index	Place in World Ranking
Starting a business	28	Paying taxes	52
Getting electricity	10	Trading across borders	100
Registering property	12	Dealing with construction permits	115
Getting credit	29		
Enforcing contracts	18		

*Source: World Bank, 2018*

Trading across borders is probably the most negative index considering its importance, even if this the result of the last political events in Ukraine that generated, in 2014, the regime of sanctions and counter sanctions between Russian and all Western Countries.

### 3. CONCLUSION

May be the state capitalism in Russia the new successful model for capitalism? Or maybe Russia has to move back to that liberalization process and use, in a future perspective, a classical liberal capitalism as in all Western countries? Probably on the second question the answer is easier and more probably; the Western capitalism probably will not be able to work in Russia, at first because the Russian mentality is completely different than Western. Moreover, the actual World geo-political situation will not favourite this possibility in the future; vice versa it favourites a new alliance made by Russia-China and Iran, supported by SOC and BRICS nations. Vice versa, is more difficult to answer to the first question; indeed today we are not able to say which future there will be for Russian state capitalism. In one hand is clear that this economic system was able to overcome the crisis of 1998, today Russia is a more stable nation that was able to find again (after the Soviet times) a place in the most powerful nations in all World. From the other hand is also true that the Russian economy is based on the export of raw materials, until Russia will not develop a real SME sector, which is able to create wealthy and to redistribute it correctly.

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## DEBT TO EQUITY RATIO OF LISTED COMPANIES IN CROATIA AND POLAND

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### ABSTRACT

*The problems of late payment, liquidity and insolvency are present in any country's economy. Financial discipline should be one of the main priorities for both business people and national administration. All of the EU countries implement the Directive 2011/7/EU on combating late payment in commercial transactions, yet, obviously, this is not enough. In both Croatia and Poland, entrepreneurs are constantly struggling against late payment of their receivables. Legislation of both countries implements not only Bankruptcy Law, but also a procedure for faster recovery of affected debtors. Pre-bankruptcy settlement in Croatia, or Restructuring Law in Poland, aims to prevent bankruptcy. The debt to equity ratio is one of the first indicators of financial crises. The main aim of this research was to test the debt to equity ratio of 107 companies listed in Croatia and Poland as well as find if there are any differences between Croatia and Poland. The results of both countries in terms of the debt-to-equity ratio were also compared to determine the average ratio between the normal and critical ratios, or 1.5 ratio. The research showed that there are differences between the countries: the average debt to equity ratio in Croatia is 2.19 (2016), compared with 1.57 (2016) in Poland. Furthermore, the companies in Croatia, compared to the companies in Poland, use much more external financing resources.*

**Keywords:** *Debt to Equity Ratio, Insolvency, Late Payment*

### 1. INTRODUCTION

Listed companies need to be the main strength of an economy. Yet companies have the same problems as all other companies anywhere in the world. They need to obtain equity for their normal business, or for new developments. They also need to buy new material or non-material assets such as new buildings, land, new machinery, or know-how. Listed companies should divert a part of the money for the new assets obtained from their shareholders or so called internal resources. Yet sometimes, companies need much more money than shareholders either want, or can get hold of. In that situation, companies need to use external sources. External sources are lenders, creditors, and – very often – suppliers. When companies do not pay their suppliers on time, suppliers cannot pay their own suppliers, and suddenly the whole economy develops a liquidity problem. The debt to equity ratio is a financial indicator which tells us if a company uses internal or external financial sources of funding; it can also be used to indicate the overall success of a company in attracting equity investors. The main aim of this research was to test the debt to equity ratio of 107 companies listed in Croatia and Poland and find any differences between Croatia and Poland. The results of both countries in terms of the debt-to-equity ratio were also compared to determine the average ratio between the normal (1) and critical (2) ratios, or 1.5 ratio.



## 2. THEORETICAL BACKGROUND

The company can be financed either by shareholders' money, or by money from creditors and suppliers. The debt to equity ratio measures the riskiness of a company's financial structure. To calculate the debt to equity ratio, one should simply divide any company's total debt by its total equity. The calculated ratio shows the percentage of company financing that comes from creditors and investors. The debt to equity ratio can provide an early warning that a company is so overwhelmed by debt that it is unable to meet its payment obligations. Creditors usually prefer a low debt to equity ratio because such a low ratio (i.e., less than 1) represents the indication of greater protection of their money. On the other hand, shareholders like to benefit from the funds provided by the creditors, so, therefore, they prefer a high debt to equity ratio. For most companies a debt to equity ratio of 1 is usually considered satisfactory. A ratio lower than 1 is considered favourable since it indicates that a company is relying more on equity than on debt to finance its operating costs. The average debt to equity ratio among S&P 500 companies is approximately 1.03 (CSI Market, 2018); ratios higher than 2 are generally considered unfavourable or critical. Late payment leads to the creation of a vicious circle between the customer and suppliers. Late payment also negatively affects liquidity, competitiveness, and profitability, especially when the creditor needs to obtain external financing because of it. Due to the major issues with liquidity, EU countries have adopted the new Directive 2011/7/EU in 2013. The Directive prescribes that, in case of a public entity, the maximum payment date does not exceed 30 calendar days; in case the defaulted party is not a public entity, the maximum payment date is 60 calendar days. Croatia and Poland implement the same Directive in their laws: in Croatia, it is the Financial Operations and Pre-Bankruptcy Settlement Act (2012), whereas in Poland, it is the Act on Payment Dates in Commercial Transactions (2013). In Croatia, 16,407 companies cannot fulfil their obligation for more than 360 days (FINA, 2018). Per EOS research (2016, p. 10), late payment or unpaid claims in Croatia and Poland are at 22%, with some of the debtors unable to ever make the payment. The research (EOS, 2016, p. 12) also found that the average invoice is paid 22 days after due date in Croatia, the same as in Western Europe, and after 23 days in Eastern Europe. It was pointed out that the lack of liquidity and the failure to meet the obligations of one's own buyers are key reasons for late payment (EOS, 2016, p.13). Per research undertaken by Atradius group (2016) in Western Europe, nine out of ten businesses report late payments. The basic conclusion of the research was that nearly 40% of value of B2B invoices in Western Europe are paid late, as well as that overdue invoices are paid on average within three weeks of due date. Late payment lead to insolvency and bankruptcy. Because it is a very serious problem in every country, all parties try to find a way to prevent bankruptcy. Bankruptcy proceedings can be initiated if a debtor is either insolvent or over-indebted. A debtor is considered insolvent if he is continuously unable to pay his outstanding monetary obligations. A debtor that is a legal entity shall be considered to be over-indebted if its obligations are greater than its assets. Restructuring procedure or pre-bankruptcy procedure is initiated if the debtor is facing insolvency. A debtor that is facing insolvency determines that the debtor will be unable to fulfil its outstanding monetary obligations upon their maturity. Concerning the insolvency, a number of laws exist both in Croatia and Poland. In Croatia there is the Bankruptcy Act as well as the Law on Extraordinary Administration, except for the Law of Financial Operations and Pre-Bankruptcy Settlement. In 2015, the pre-bankruptcy settlement was moved from the Law of Financial Operations and Pre-Bankruptcy Settlement to the Bankruptcy Act. The gist of pre-bankruptcy settlement is that every insolvent debtor and its creditors are obliged to try to achieve a pre-bankruptcy settlement in a court proceeding. The pre-bankruptcy proceeding can be conducted only if the debtor is facing insolvency. If the insolvency of the debtor has already occurred, or in case of over-indebtedness of the debtor, the debtor, or any of his or her creditors, may only file petition to open bankruptcy.

In Croatia, 17.4% of companies (Roska, 2011) entered into bankruptcy within first five years of their existence. According to the data from IUS-INFO, starting from 2012, 2,766 pre-bankruptcy settlements were brought to conclusion. The main objective of implementing the pre-bankruptcy settlement is to establish liquidity and solvency through financial restructuring of debtors in addition to the maintenance of debtors' activities. The bankruptcy proceedings are conducted for the purpose of settling the creditors, cashing out his assets and allocating the funds collected to the creditors. Bankruptcy reasons are the inability to pay and being overdue. A survey of 140 accountants in Croatian companies (Roska, 2012) has shown that inefficient management is the main cause of business failure. The Law on Extraordinary Administration Procedure for Companies of Systemic Importance for the Republic of Croatia (2017) was adopted in order to rescue the Agrokor Group and is therefore known as "Lex Agrokor". Approximately 6,000 suppliers, lenders, and creditors participate in the ongoing settlement process. Principal agreement on all key elements of settlement is signed; the court extended the three-month deadline for the settlement to be finished and signed. In Poland there are the Bankruptcy Act and the Restructuring Law, beside the Act on Payment Dates in Commercial Transactions. Per Atradius Payment Practices Barometer (2017), in 2017 suppliers in Poland needed to wait 56 days (six days more than in 2016) to convert B2B receivables into cash. Restructuring proceedings in Poland may be brought against a debtor that is insolvent or is facing insolvency. On the other hand, bankruptcy proceedings concern only insolvent debtors. The new Polish Restructuring Law (2015) provides for a variety of brand new restructuring procedures, with an emphasis on maximizing the speed and effectiveness of restructuring and bankruptcy proceedings. The main purpose of restructuring proceedings is to avoid the debtor's bankruptcy. The Bankruptcy Law (2016) was changed in 2016. A debtor is considered insolvent if he has lost his ability to perform its due financial obligations and if he is late in making a payment by more than three months. A debtor facing insolvency is a debtor whose economic situation suggests that he could soon become insolvent. The new Bankruptcy Law introduces a new kind of bankruptcy procedure, the so-called "arranged liquidation". In order to streamline restructuring and bankruptcy proceedings, as well as to facilitate the access to information on these proceedings and reduce the costs of proceedings related to the obligation to make announcements, the Central Restructuring and Bankruptcy Register was established on 1 February 2018.

### **3. THE GOALS, BASIS, AND HYPOTHESIS OF THE RESEARCH**

The research described in this paper is based on information obtained from the financial statements of 107 companies listed in Croatia and Poland. In Croatia, 107 companies are listed in the whole Zagreb Stock Exchange after financial institutions and companies in bankruptcy were excluded. In Poland, 107 companies are listed on:

- WIG20 index – contains shares in 20 major and most liquid companies in the WSE Main List
- mWIG40 index – comprises 40 medium size companies listed at WSE Main List
- sWIG80 index – comprises 80 smaller companies listed at WSE Main List.

For the empirical study, the following were used:

- 14 companies WIG 20
- 29 companies mWIG40
- 64 companies sWIG80.

For the statistical analysis, this paper uses Descriptive Analysis and One-Sample Test. The statistical study used the software package IBM SPSS 24. The main aim of this research was to test the debt to equity ratio of 107 companies listed in Croatia and Poland and find whether

there are differences between Croatia and Poland. Also, it tested the result of both countries with 1.5 debt to equity ratio, which is an average ratio between the normal (1) and critical (2) ratio. The main hypothesis is confirmation that the average debt to equity ratio among companies in Croatia and in Poland is not the same and is 1.5 or higher.

The following statistical hypotheses are used for confirmation of the main hypothesis:

The first statistical hypothesis:

- $H_0 \geq 1.5$  The average debt to equity ratio among companies listed in Croatia in 2016 is  $\geq 1.5$
- $H_1 < 1.5$  The average debt to equity ratio among companies listed in Croatia in 2016 is  $< 1.5$
- The second statistical hypothesis:
- $H_0 \geq 1.5$  The average debt to equity ratio among companies listed in Croatia in 2015 is  $\geq 1.5$
- $H_1 < 1.5$  The average debt to equity ratio among companies listed in Croatia in 2015 is  $< 1.5$
- The third statistical hypothesis:
- $H_0 \geq 1.5$  The average debt to equity ratio among companies listed in Poland in 2016 is  $\geq 1.5$
- $H_1 < 1.5$  The average debt to equity ratio among companies listed in Poland in 2016 is  $< 1.5$
- The fourth statistical hypothesis:
- $H_0 \geq 1.5$  The average debt to equity ratio among companies listed in Poland in 2015 is  $\geq 1.5$
- $H_1 < 1.5$  The average debt to equity ratio among companies listed in Croatia in 2015 is  $< 1.5$

Before the statistical analysis was initiated, it was necessary to exclude those among the Croatian companies which had a negative debt to equity ratio due to loss exceeding the rest of the equity. In 2016, the test included 102 companies, and in 2015 it included 101 companies in Croatia.

#### 4. RESEARCH RESULTS

The basic characteristics of companies researched are shown in Figure 1 according to the financial statement, business results, audit opinion, status of pre-bankruptcy or Extraordinary Administration and operating activities. 57.01% consolidated financial statements were researched in Croatia and 66.36% in Poland. In Croatia, 66.36 % of companies finished the business year with a profit, while in Poland it was 86.92% of companies. In Croatia 70.09% of companies received an unmodified audit opinion, in comparison with 97.20% of companies in Poland. In Croatia, 26.17% of listed companies sampled were in the process of pre-bankruptcy settlement, in addition to 6.54% which were in Extraordinary Administration.

*Figure following on the next page*

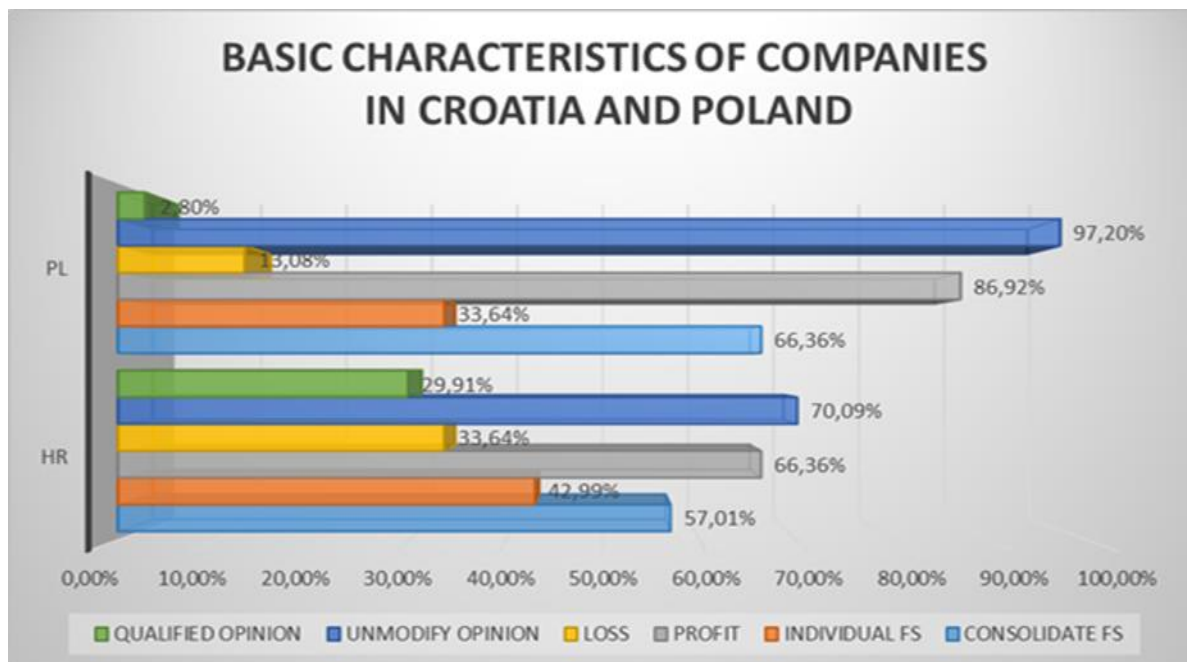


Figure 1: Basic Characteristics of Companies in Croatia and Poland (Authors)

In Croatia, 29.91% of companies listed on the stock market are from the tourism sector, 24.30% from production sector other than food and 19.63% from food production (Figure 2). In Poland, 44.86% of companies are from the production sector other than food, while 14.02% are from real estate, construction, and services sectors (Figure 2).

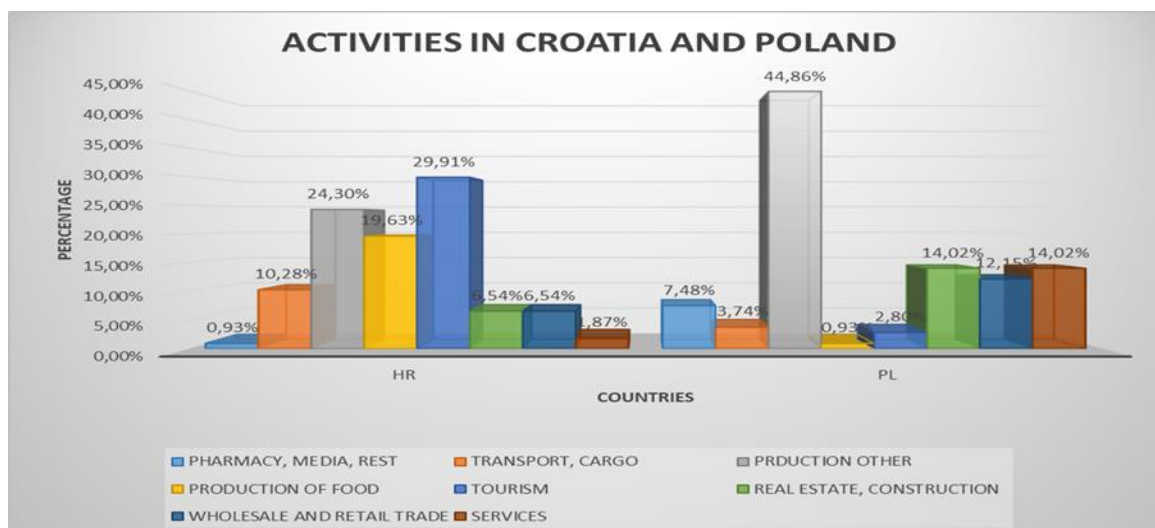


Figure 2: Activities in Croatia and Poland (Authors)

In both countries the greatest increase in debts was present in the services sector, followed by trade activities sector in Croatia and transport activities sector in Poland, as shown in Figure 3.

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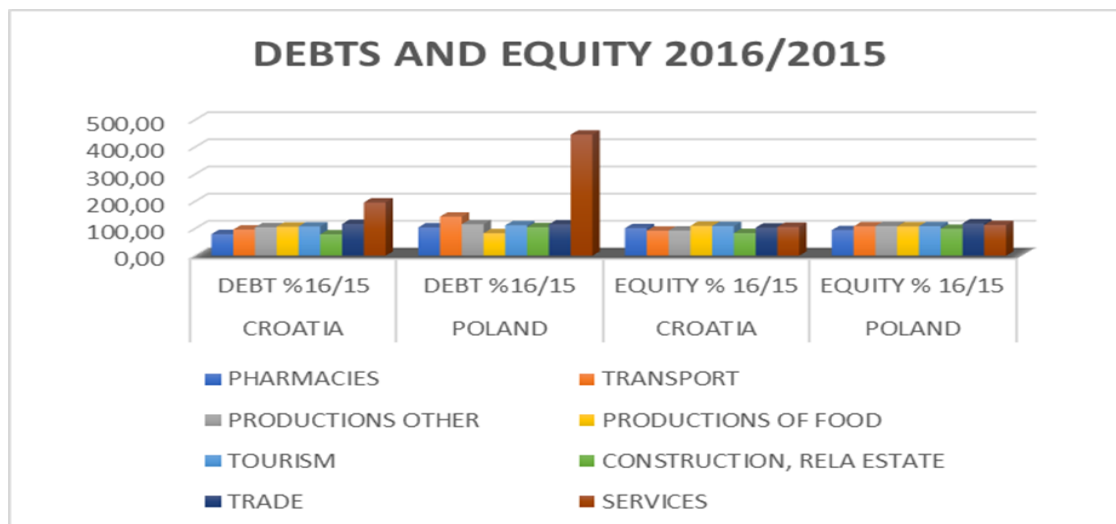


Figure 3: Debt and Equity listed companies in Croatia and Poland (Authors)

Figure 4 shows the debt to equity ratio according to the activities of companies listed. In Croatia in 2016, the greatest debt to equity ratio was 4.02% in services activities, followed by the transport activities with 3.95%. In Poland in 2016, the greatest debt to equity ratio was 1.5% in construction and real estate activities. Figure 2 clearly displays the differences between the two countries: in both years, Croatia had a much greater debt to equity ratio compared to Poland.

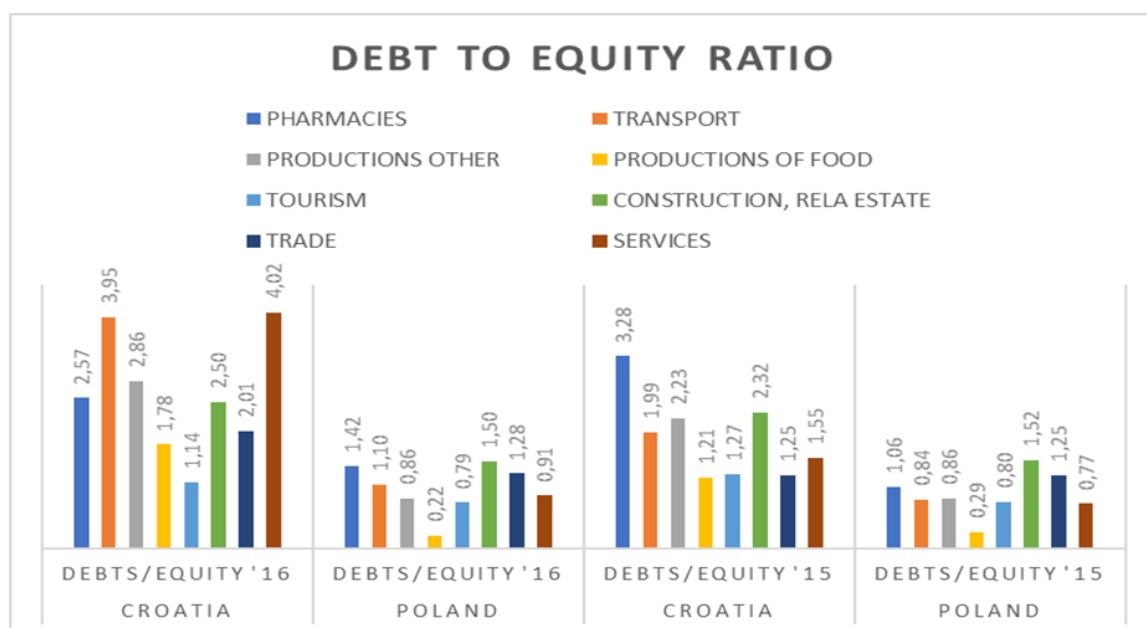


Figure 4: Debt to Equity Ratio listed companies in Croatia and Poland (Authors)

Table 1 shows that in 2016 the average debt to equity ratio stands at 2.19 for Croatia and 1.57 for Poland. In 2016 the minimum is 0.02 with maximum 34.65 for Croatia, while the minimum is 0.08 with maximum 23.46 for Poland. In Croatia, 54.21% of companies have ratio less than 1, while in Poland that ratio is attained by 56.07 % of companies in 2016.

Table following on the next page

*Table 1: Descriptive statistic of debt to equity ratio (Authors)*

Descriptive Statistics								
	N	Range	Minimum	Maximum	Sum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
DEBTS/EQUITY 16 - HR	102	34,63	,02	34,65	223,10	2,1873	,47272	4,77428
DEBTS/EQUITY 15 - HR	101	21,45	,03	21,48	185,45	1,8362	,34554	3,47261
DEBTS/EQUITY 16 - PL	107	23,38	,08	23,46	168,53	1,5751	,32208	3,33166
DEBTS/EQUITY 15 - PL	107	13,27	,03	13,30	118,28	1,1054	,14216	1,47049

The results of One-Sample Test for debt to equity ratio in 2016 and 2015 for Croatia and Poland are shown in Table 2. The ratio was tested for test value of 1.5, like an average between the normal (1) ratio and critical (2) ratio.

For the first statistical hypothesis the result of One-Sample Test is  $t(101) = 1.454$ ,  $p = .149$ ,  $\alpha = .05$ . There was no statistically significant difference between the mean values ( $p < .05$ ) and we can, therefore, retain the null hypothesis, because mean is 2.19 in Croatia for 2016.

For the second statistical hypothesis the result of one sample test is  $t(100) = .973$ ,  $p = .333$ ,  $\alpha = .05$ . There was no statistically significant difference between the mean values ( $p < .05$ ) and we can, therefore, retain the null hypothesis, because mean is 1.84 in Croatia for 2015.

For the third statistical hypothesis, the result of one sample test is  $t(106) = .233$ ,  $p = .816$ ,  $\alpha = .05$ . There was no statistically significant difference between the mean values ( $p < .05$ ) and we can, therefore, retain the null hypothesis, because mean is 1.57 in Poland for 2016.

For the fourth statistical hypothesis, the result of one sample test is  $t(106) = -2.776$ ,  $p = .007$ ,  $\alpha = .05$ . There was a statistically significant difference between the mean values ( $p < .05$ ) and we can, therefore, reject the null hypothesis, because mean is 1.1 in Poland for 2015.

*Table 2: One-Sample Test (Authors)*

One-Sample Test						
	Test Value = 1.5					
	t	df	Sig. (2-tailed)	Mean Differenc	95% Confidence	
					Lower	Upper
DEBTS/EQUITY 16 - HR	1,454	101	,149	,68730	-,2505	1,6251
DEBTS/EQUITY 15 - HR	,973	100	,333	,33615	-,3494	1,0217
DEBTS/EQUITY 16 - PL	,233	106	,816	,075	-,56	,71
DEBTS/EQUITY 15 - PL	-2,776	106	,007	-,395	-,68	-,11

Considering all of the results, we can conclude that the economic situation in Croatia is worse than in Poland, as well as that Croatia has a bigger problem with liquidity and insolvency among the companies listed. The average Croatian debt to equity ratio is 2.19 for 2016 and 1.84 for 2015, which is higher than average Polish debt to equity ratio which is 1.57 for 2016 and 1.10 for 2015. Both averages for Poland are positioned in an acceptable range from 1 to 2. The average of 1.1 in 2015 is almost ideal.

In Croatia, however, the situation in 2016 is worse than in 2015, which confirms that the companies are, unfortunately, financed from external resources – that is, from suppliers, and not from creditors. We can thereby conclude that the main hypothesis is confirmed, and that debt to equity ratio in Croatia and Poland is not the same. Croatia yet to work towards a debt to equity ratio of 1.5.

## 5. CONCLUSION

Financial discipline needs to be prioritized by both the business people and the government; yet, in many countries, it is not. The debt to equity ratio is one of the first indicators of a financial crisis in a company. Companies in Croatia struggle every day with cash flow and late payments. They have a problem with financing material and non-material assets, but also current assets. A debt to equity ratio of 2.19 is too critical for all business segments in Croatia. In Poland the debt to equity ratio at 1.57 is higher than the optimal ratio but still remains in the acceptable zone. A lower debt to equity ratio usually implies a more financially stable business. Companies with a higher debt to equity ratio are considered riskier for creditors and investors than companies with a lower ratio. The fact that debt to equity ratio was higher in 2016 than in 2015 is very surprising. It is questionable, is it because the world was coming out of the financial crisis and new financing funds were ready for investment or was the reason something else. That is a topic for another research. The high debt to equity ratio is not a problem if the companies invest external funds in very profitable investments that will bring a higher return on the cost of financing. Companies can invest in new machines and new technological advancements that will bring them better business results. The differences between the countries are visible not only by comparing their debt to equity ratios, but also by noting their economic growth rate and power of their economy. Croatia needs to implement a stronger financial discipline into business management, because only adopting laws is never enough. In Poland, the situation is much better, but the economic strength is greater than in Croatia.

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## HOW DO PENSION EXPENSES AND BENEFIT PENSIONS IN RUSSIA MEET THE IFRS REQUIREMENTS?

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### **ABSTRACT**

*This paper aims to add to an important discussion on the main objectives of the IAS 19 in order to understand how the companies organize accounting and disclosure for employee benefits in Russia. We also aim to contribute to the discussion on the question of pension plans along with the accounting specifics of pension expenses in Russia. At the same time, Russian pension system has undergone dramatic changes recent years. The situation is complicated by the lack of pension allocation by working people and, moreover, by the decrease in demographic. We analyze the tendencies in Russian pension system through literature review and find that most of the Russian recent research literature is dedicated to the issues of state-level administration of pension expenses rather than to the companies' interests. This appears to affect more menacing on the background of the required International Financial Reporting Standards (IFRS) implementation. The findings should be of interest to the accounting academics, companies and policymakers.*

**Keywords:** *Accounting of the Pension Payments, Employee Benefits, History of Pensions, Pension Expenses.*

### **1. INTRODUCTION**

Since the paper looks at the transition experience of the Russian accounting towards IFRS-based one, we look at the history and approaches to the IFRS implementation in Russia. We find that the specific interest towards the issues of planning and management of pension expenses increased last years from the side of the companies. The actuality of the raised issues in this study is caused partly by the increasing demand for effective pension plans administration, and partly – by the necessity of planning the expenses from the company's side through the logics of the mechanism of decision making support realization. The issues that are discussed in relation to the management of the pension system are still not examined enough. For example, the issues of planning and managing of the company's pension expenses, etc. By raising these issues we hope that this study will add to a discussion whether the questions of state administrating of the pension payments are playing a predominant role in the research within the scientific, organizational, administrative and regulatory activities. From the other hand we consider that the preliminary aim of the company is to determine the effectiveness of its business activities and decisions. We find thus that the existing challenges are connected with the peculiarities of balancing state and private interests. The paper therefore shows the necessity of developing such mechanisms of planning and management of pension expenses that will provide an optimal balance between the interested parties. Some steps for creating such mechanisms are reflected in this paper. We trace the evolution of the pension expenses system from the time of the insurance deductions theory development authored by W. Petty in his “Treatise on Taxes and Fees” (1662), as well as in the papers by A. Smith and J. Sysmondi (Schumpeter, J. A., 1954). The literature review shows that European research of the pension payments issues mostly relate to such facts as the widespread concern that the population of

working age people are not currently allocate sufficient funds for their pension provision in the future (Paraskevi, Peasnell, 2009). This can be partly explained not only by the imperfection of the formation mechanism for management and planning of such payments, but by the demographic situation as well (Mikhalkina, Pisanka, 2013). This is due to a decrease in the population of working age people, economic activity reduction, and an increase in the number of pensioners as a consequence of the increasing availability and quality of health services (health care reform). The other issue here to be examined - is the migration (the growth of the number of refugees and migrants).

## 2. CHAPTER

In order to assess the extent of the pension system, we set a system of indicators of an aging population retirement (Table 1).

Among these indicators we excrete:

- the retirement aging index,
- the demographic burden and
- the proportion of the elder people in the total number of people of retirement age.

The methodology suggested can be realized within several iterations:

1 Step - calculating the retirement aging index:

$$\left( \frac{P_p}{P_{ch}} \right) * 100 \quad (1),$$

where  $P_p$  - is the total population of both sexes, older than the employment age;  $P_{ch}$  - is the total population of both sexes under the age of working age (children).

2 Step – understanding the demographic burden on the working population due to the retirement-age population:

$$\left( \frac{P_p}{P_w} \right) * 100 \quad (2),$$

where  $P_w$  - is the total population of both sexes of working age.

3 Step - the proportion of older people (80+) in the total number of persons of retirement age:

$$\left( \frac{P_{80+}}{P_p} \right) * 100 \quad (3),$$

where  $P_{80+}$  - is the population aged 80+.

We use the suggested methodology to find out the dynamics of structural indicators that quantify the retirement aging population in Russia, as follows.

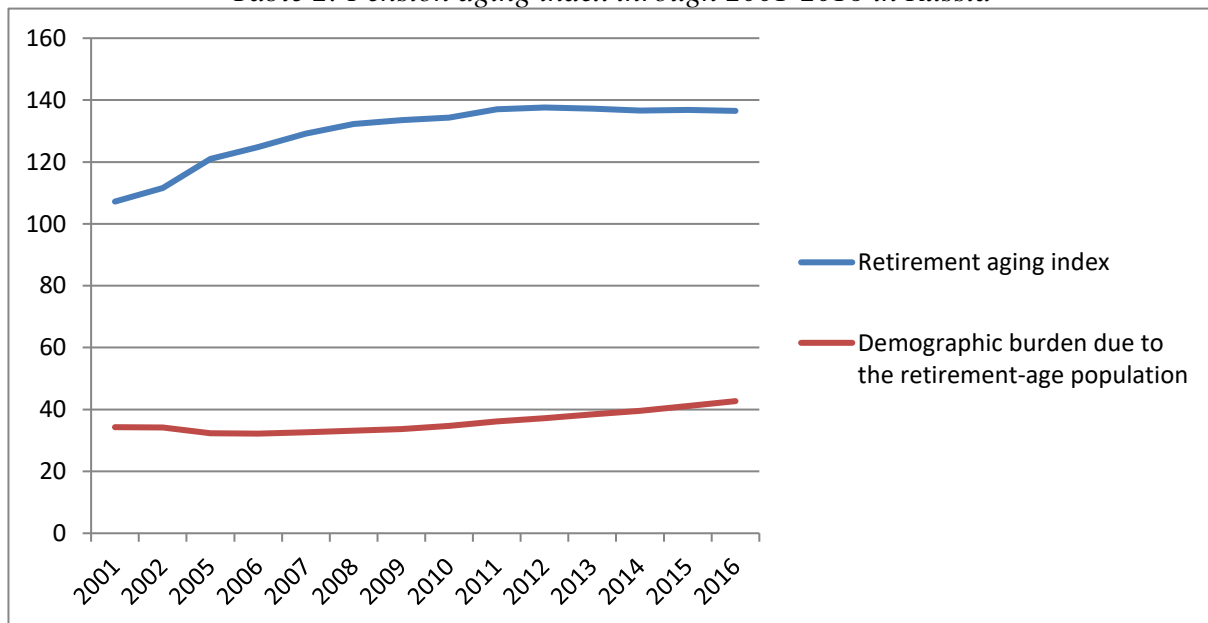
*Table following on the next page*

*Table 1: The dynamics of structural indicators that quantify the retirement aging population in Russia<sup>1</sup>*

Indicators	2001	2002	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Retirement aging index</b>	107,2	111,6	121,0	124,8	129,2	132,3	133,5	134,3	137,0	137,6	137,2	136,6	136,8	136,5
<b>Demographic burden due to the retirement-age population</b>	34,3	34,2	32,3	32,2	32,6	33,2	33,7	34,7	36,2	37,2	38,4	39,6	41,1	42,7

Among others, one of the main functions of the state is the production of public goods. In Russia national insurance, health and educational services, pensions and benefits are affordable due to the state's resources (natural, power, financial) allocated for the implementation of such projects. Thus state provides financial support for such activities in various ways. Therefore, a reasonable budget policy allows the state to perform its functions most fully and efficiently. There is an assumption that Russian budget is going through hard times. This is caused partly by existing fall in oil revenues in 2013-2014. And partly because of the changes in internal and external political situation: while share of defense and security expenses is growing, the share of "closed" expenditure items is growing. Meanwhile, the share of expenses for the social projects is decreasing. Now the state is searching ways to extract additional income and reduce costs (e.g. through possible increase of the income tax by attaching it to the pension contribution rate). After all, we see the additional purpose of this paper in describing the existing problems of Russian budgetary policy, their nature and the ways to overcome them. Based on the data from the Table 1 we conclude that there is a tendency of pension aging index increasing in Russia (Table 2). We explain such dynamics through the life expectancy overall increase, from the one hand. And from the other - through the low level of fertility. Socio-economic effects of aging can be also evaluated by the increasing dynamics of the demographic burden on the working population due to the retirement-age population.

*Table 2: Pension aging index through 2001-2016 in Russia*



<sup>1</sup> Source: Authorial computation based on Federal State Statistics Service data [<http://www.gks.ru/>] (10.02.2017)]

This trend in the field of demography and migration is quite typical for Europe as well. In addition, the transition to a fixed payment form (including UK), calculated on the amount of wages paid, was complicated by the new regulatory requirements and demographic changes that significantly increased the cost of such schemes (Paraskevi, Peasnell, 2009). We consider the main IAS 19 requirement that the entity should recognize “a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits” (IAS 19). A separate group of problems include questions of the pension expenses which are indicated in the financial statements. International Financial Reporting Standards (IFRS) in the early editions (SFAS 87, 1985; IAS 19, 1983) oriented mostly on the disclosure of costs and financial assets information reflection (Napier, 2009). However, these accounting standards that allow companies to ignore wash out or segregate insurance contributions figures are constantly criticized and gradually disappear (ib.). Besides, accounting and pension expenses administration issues are caused also by the “influence of accounting reporting on management decisions by the enterprises, government, trade unions, investors and creditors” (Zeff, 1978). In Sandu M. paper (2012) the issue of the employees in the performance of their pension expectations, and companies interests balance is investigated. There is a concern about the influence of the produced charges on net income, cash flows, as well as the overall stability of the companies. Normally accounting standards (IFRS 19, SFAS 158) assume two types of pension payments: deductions plans with a fixed payment of pension (DB) plans, and deductions from wages, including extra-budgetary funds, without a guaranteed payout (DC). Selected contributions scheme will be in their own way affect the ways of their accounting and reflecting in the reports. Russian legislation provides a unified system of insurance funds formation: by deductions of payments from the payroll and payout amount at retirement is calculated based on accumulated points, formed on the basis of deductions made for each employee. Thus the main role of insurance contributions is to promote the implementation of social support and protection for citizens by the state. The main problems existing in pension contributions of today's Russian system are considered to be: increasing burden on budget because of medical and social expenses rising for elder people (Samaruha, 2013); aging of the people; and besides, deterioration of the numerical ratio of workers and pensioners. In order to provide readers with the full possible understanding of the areas of research in the field of insurance contributions in Russia, we analyzed the principle publications issued through the period 2012-2017<sup>2</sup>. We define the area of the research objectives and measure their relevance to each. We find that 34 research publications were dedicated to the pension and social payments issues (Appendix 1, Table 1). The overall analysis gives us a notion on the most widespread area of existing research in the field of social and pension insurance. It was found that most popular fields of research were state and funds interests (19 points from 30) and population (18 points from 30). However the issues of the companies' interests and their role in the system of insurance coverage remain unrevealed (10 points from 30). It should also be noted that the overall structure of the publications the interests of the funds and of the population are

### **3. THE HISTORICAL PROBLEM SETTING OF THE PENSION PLANS IN RUSSIA**

The issues concerning social insurance of employees in Russia have received legislative approval in 1889, with the adoption of the Law "On the liability of owners of industrial enterprises for the injury and death of workers." In 1990, the functions of the administration of

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<sup>2</sup> The sampling only included the articles published in Russian refereed journals, exploring questions of insurance and pension contributions. Articles analyzing the pension system in the Russian Federation are not included in the sampling, as in fact the interests of the state and public funds are considered in them, and, therefore, this can not act as object of study for the differentiation of the interests involved.

insurance funds in Russia moved from the state budget to the off-budget funds, formed by employers' contributions. In recent years, since 2010, Russian legislation in the field of social insurance has undergone a radical reformation (e.g., valorization, abolition of the single social tax (SST), refusing from a regressive scale and others). Since the dynamics of contributions to the budgetary funds is determined by the future needs of these payments administrators there are some issues in methodology and methods of calculation of such requirements, in particular regarding the interlinkages of the extra-budgetary funds needs with the possibilities of companies. In 2016 Russian economy has suffered a lot of turmoil. The crisis caught many companies not at the best stage of their development. As a result, many companies were not able to achieve in time their development strategies because of this. However these issues are not covered by existing research and do not offer any decisions on how to overcome these crisis phenomenon in economics. This can be explained from the side that any consequence of economics changing can hardly be a subject of prognosis. We should also assume that such prognosis of internal changes in the economy from the perspective of the state is more appropriate though. In such circumstances companies as well as the state cannot reach balance in their intentions. We suggest the solution by using the economic and mathematical modeling methods which allow predicting tendencies of system development, as well as determining the impact of the taken decisions. Such methodology can be used in the purposes of pre-assessing the impact of existing alternative solutions. Among the existing variety of economic and mathematical modeling approaches we find matrix algebra instruments most appropriate in this context. We apply them to the accounting of pension's expenses. This allows to build a perspective model of the company and to take the most effective management decisions on this basis.

### **3.1. The model for planning and managing of pension expenses**

This study employs a case study methodology that seeks suitable economic decisions based on the analysis through accounting data the financial situation of the company. Traditionally used methods for planning the pension expenses are usually associated with a number of requirements. The ultimate goal is to reduce the social burden to a minimum within the existing state policy. This includes use of the benefits provided by the current legislation. However, the existing mechanisms do not offer a specific action or the algorithm, based on the analysis of the company's financial activity as they are only a certain set of tools that businesses can use for tax optimization. Thus we conclude that in most cases there almost completely are absent an element of planning, as all the decisions are taken in "blind", without visualizing the consequences of the decision. At the same time there is an existing certainty that traditional means and methods of accounting lack a very important component: mathematical foundations. It was discovered that no textbook, both on the theory of accounting or on economic and mathematical methods in accounting do not contain mathematical foundations explanation of accounting. However, historically the development of the science is based on the mathematical language (Sangster, A, et al. 2007) that provides uniformity of understanding and possesses better categorization tools in logical thinking and inferences than a purely professional specialist language that is close to natural language. It is worth mentioning that certain attempts to determine mathematical foundations of accounting were made by Russia authors in the 19-20 century period (e.g., Blatov N.A., 1926, Popov N.U., 1906, Russiyan I.P., 1889, Rudanovskiy A.P., 1925, Kolvakh O.I., 1996, 2010, Stoner, G., and Vysotskaya, A., 2012). Mathematical models development research is presented by the numerous studies by different scientists (e.g., De Morgan A., 1846, Churchill N. 1964, G. Rossi 1895, Demski J., FitzGerald S. 2008, Mattessich R., Galassi G., 2000). Based on this and in order to ensure the effectiveness of financial management in the context of increased expenses we outline the evident need in implementing the planning methods within the companies.

To obtain useful information from the raw accounting data for decision-making process we involve the application of the developed by O. Kolvakh (1996) situational matrix model. We also use its modification suggested by A.Vysotskaya (2012) that uses the raw data records, which are represented in the form of a matrix transactions or debit turnovers matrix (matrix of debit turnovers) and are put into a correlation to the quantitative indicators. In its initial form accounting Matrix model is represented as follows:

$$\mathbf{MDT} = \sum_{\mathbf{x}, \mathbf{y} \in \mathbf{SA}} S_{\mathbf{x}, \mathbf{y}} \cdot \mathbf{E}(\mathbf{X}, \mathbf{Y}) \quad (4),$$

where  $S_{\mathbf{X}, \mathbf{Y}}$  – is a summary entry defined by correspondence: debit X, credited Y;  
 SA - is a set of accounts, which are defined by accounting operations;  
 $\mathbf{E}(\mathbf{X}, \mathbf{Y})$  – the matrix - correspondence, in which the intersection of debit accounts X and credit accounts Y is one, and the other elements are zero.

Matrix of debit turnovers MDT is a main matrix which contains all necessary data to obtain the information for the trial balance. The modification of situational-matrix model for financial analysis and tax planning is based on the transformation of the initial situation-matrix model in its invariant form (IF), as follows:

$$\mathbf{MDT}^* = \sum_{\mathbf{x}, \mathbf{y} \in \mathbf{SA}} \beta_{\mathbf{x}, \mathbf{y}} \cdot \mathbf{E}(\mathbf{X}, \mathbf{Y}) \quad (5),$$

Where  $\beta_{\mathbf{X}, \mathbf{Y}} = S_{\mathbf{X}, \mathbf{Y}}/Q$  – are conditionally constant coefficients of linear expansion. Thus we use in our case study a modified matrix of debit turnovers -  $\mathbf{MDT}^*$ . The elements of which are semi-fixed to the quantities  $\beta_{\mathbf{X}, \mathbf{Y}}$ , and are based on the existing rates of taxes and fees. These indicators can be changed according to the regulations policy. We also assume here some basic value Q, which may represent any quantity (or expected rate) depending on the company's goals (e.g., sales, wages, etc.). This method allows us to obtain a trial balance by multiplying IF SMM (template balance sheet) with the planned base variable Q in the spreadsheet form. This will be an optional trial balance. The amounts are put into correlation with the variable parameters: entering basic variable and semi-fixed parameters. The sample is based on the real data gathered within a small company in order to show how modified matrices can be applied for planning and decision making purposes in administrating pension expenses purposes. Here we consider within chosen approach the idea of the concept of situation-matrix model. This example, is a simplified model of payroll data gathered from the company<sup>3</sup>. Further, taking the unit accrued payroll ( $\beta_{20,70} = 1$ ), in relation to it using the established rates of taxes and contributions:  $\beta_{20,68} = 0,13$  (13%),  $\beta_{20,69pfr} = 0.22$  (22%) ,  $\beta_{20,69sic} = 0.029$  (2.9%),  $\beta_{20,69mhi} = 0.051$  (5.1%). On this basis, the journal of accounts template on payment transactions (Tab. 2) will go in accordance with the next formula

$$\mathbf{MDT}^* = 1 \cdot \mathbf{E}(20,70) + 0,13 \cdot \mathbf{E}(70,68) + 0.22 \cdot \mathbf{E}(20,69pfr) + 0,029 \cdot \mathbf{E}(20,69sic) + 0,051 \cdot \mathbf{E}(20,69mhi).$$

Based on this, we can obtain a Ledger in accordance with the formula or, substituting the values, we have, as follows:

<sup>3</sup> For understanding the accounting features, we must determine that for the calculation of the contributions to the pension fund we will use 69pfr account, for the calculation of social insurance contributions – 69sic, for the calculation of contributions for mandatory health insurance – 69mhi.

$$\text{MDT}^* = 1 \cdot E(20,70) + 0,34 \cdot E(20,69) + 0,13 \cdot E(70,68).$$

#### 4. CONSLUSION

This paper leads us to several important conclusions. Firstly, there exists a lack of the research of the companies' interest especially in the conditions of permanent reforms of the population insurance coverage system that is contrary to the very nature of this phenomenon, since it is the company that provides the necessary contributions to the appropriate funds. Secondly, the issues concerning economic consequences of insurance payments, interlinkages of the indicators still remain uncovered. And, finally, companies need special instruments to benefit from the conditions they have to operate. In the light of the recent changes (such as increasing the rate of contributions to the funds) that significantly increased the tax burden especially for small businesses, the opportunities for tax planning and the proposed methodology based on situation-matrix modeling is of particular interest. In particular, it is possible to calculate the maximum amount of wages (and make the effective decision on the employment volumes) that would ensure the pension contributions at the appropriate level. Finally, the approach to minimize the situation models opens up prospects for the use of situation-matrix accounting in economic analysis and forecasting of the property and financial situation of the company based on certain minimum exogenous parameters. All this may also have implications for the audit, since in this way - depending on the minimum set of input values can be set (via the general ledger), situational specific summary matrix formulas, balance sheets and financial reporting in the whole.

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## APPENDIX

*Table 1: Analysis of 2012-2017 papers, published and indexed in RCI on the issues of insurance and pensions expenses*

№	Reference data	Funds interests (points)	Companies interests (points)	People interests (points)
1	Economic controlling mechanism of professional risks // Mihina T. - Mining informational and analytical bulletin (scientific and technical journal). 2016. № 6. pp. 222-230.		1	1
2	Essence, directions and stages of small agricultural management supporting growth // Tolmachev A., Lisovskaya R. Ivanov I. - Multidisciplinary network electronic scientific journal of the Kuban State Agrarian University. 2016. № 115. pp 498-516.		1	1
3	Insurance contributions: historical aspects and innovations // Kuznetsova N., Yellin K., Gusakov A. -Multidisciplinary network electronic scientific journal of the Kuban State Agrarian University. 2016. № 123. pp 827-840.	1		
4	Analysis of the tax and pension reform in Russia chpice of informal employment // Vodopiyanov A., Leonova L. - Finance and credit. 2016. № 5 (677). pp. 36-50.	1		1
5	Analysis of the cost production // Morozova N., Merkulova E. - Socio-economic phenomena and processes. 2016. T. 11. № 8. pp. 66-71.		1	
6	Relationship of pension systems and socio-economic security in the Russian Federation // Valko E., Listopad M. - Bulletin NGIEI. N 2016. 11 (66). pp. 24-31.	1		1
7	Raising cash housing to co-financing mechanism through voluntary pension contribution //Chuev S. - Money and credit. 2015. № 8. pp. 69-70.	1	1	1
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9	Predictive estimate aof a reliable mechanism warranties of pension savings in Russia by stress test // Tumanyants K., Samara G. - Problems of Forecasting. 2015. № 3. pp. 79-88.	1		1
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*Table 2. Analysis of the predominant direction of publications*

	<b>Funds interests, points</b>	<b>Companies interests, points</b>	<b>People interests, points</b>
Total points	19	10	18

## DOING BUSINESS IN THE FASTEST GROWING LEAST DEVELOPED COUNTRIES

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### ABSTRACT

*The paper presents trends in doing business in least developed countries (LDCs) which recorded the average GDP growth more than 6 per cent over the period from 2007 to 2016. The analysis covers seven Asian (Afghanistan, Bangladesh, Bhutan, Cambodia, Lao PDR, Myanmar, Timor-Leste) and eight African (Angola, Democratic Republic of the Congo, Ethiopia, Mozambique, Rwanda, Tanzania, Uganda, Zambia) LDCs and is based on the Doing Business data. To study regulations affecting business activity in the considered LDCs the following ten indicators are used: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. The Wrocław taxonomy method is applied to establish similarities and differences in the evaluation of progress in doing business achieved by the studied countries. The most favourable environment for business start-ups and entrepreneurs has been created in Rwanda, Bhutan, and Zambia. The remaining LDCs were low ranked in the Doing Business 2018. In general, the fastest growing LDCs are doing the best in the areas of getting credit and paying taxes. On the other hand, they have the biggest problem in the areas of opening a business and getting electricity. Between 2008 and 2017, the greatest progress in improving business environment was made by Rwanda, Bhutan, Uganda, DRC, and Zambia. The biggest changes in the evaluation of doing business were observed in Rwanda, Bhutan, Tanzania, and Cambodia. The following pairs of countries Bhutan-Rwanda (2009-2012), Tanzania-Uganda (2008-2010), Ethiopia-Tanzania (2013-2015), Zambia-Uganda (2015-2017), Mozambique-Myanmar (2015-2017), and Angola-DRC (2008-2017) showed the smallest differences in the evaluation of doing business over the considered period. Further improvement of the business environment may lead to greater economic growth in the analysed LDCs.*

**Keywords:** *economic growth, economic regulations, doing business, LDCs*

### 1. INTRODUCTION

There are a lot of cross-national and individual country studies on the relationship between business regulations and economic growth. In general, they support the hypothesis that countries with better regulations grow faster. For instance, Djankov, McLiesh, and Ramalho (2006) Hanusch (2012), and Pere and Hashorva (2013) showed that business-friendly economic policy is important determinant of the level of per capita income. The studies which investigate business regulations-economic growth nexus are principally based on data from the World Bank Enterprise Surveys (Eifert, Gelb and Ramachandran, 2008; Hallward-Driemeier and Pritchett, 2015; Wang, 2016) or the World Bank Doing Business data (Gillanders and Whelan, 2014; Messaoud and Teheni, 2014; Trifu, Gîrneată and Potcovaru, 2015). In recent years, several least developed countries have experienced high average GDP growth. They have used different growth strategies (Nowak, 2017a). A few of them have grown fast because of removing obstacles in business. Other countries have a chance to maintain high economic growth by improving the business climate. The main aim of the paper is to show trends in the business regulations in the least developed countries which recorded the highest average GDP growth over the period from 2007 to 2016. The analysis is based on the Doing Business data. To study regulations affecting business activity in the fastest growing least developed countries

the following ten indicators are used: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. The Doing Business data cover the period from June 1, 2008 to June 1, 2017, except Bangladesh and Myanmar. Data for those two countries are available for the years 2013-2017 and 2012-2017, respectively. The Wroclaw taxonomy method is used to establish similarities and differences in the evaluation of progress in doing business achieved by the analysed countries.

## 2. BUSINESS CLIMATE IN THE FASTEST GROWING LDCS

Over the period from 2007 to 2016, fifteen least developed countries recorded average GDP growth more than 6.0% per year. Among the fastest growing LDCs were seven Asian (Afghanistan, Bangladesh, Bhutan, Cambodia, Lao PDR, Myanmar, and Timor-Leste) and eight African countries (Angola, Democratic Republic of the Congo (DRC), Ethiopia, Mozambique, Rwanda, Tanzania, Uganda, and Zambia). Several countries experienced high average GDP per capita growth, too. Average GDP and GDP per capita growth rates in the mentioned countries are presented in Table 1.

*Table 1: Average GDP and GDP per capita growth in the selected LDCs, 2007-2016*  
 (Source: own calculations based on WBOD, 2018)

Country	Average GDP growth, 2007-2016	Average GDP p.c. growth, 2007-2016	Country	Average GDP growth, 2007-2016	Average GDP p.c. growth, 2007-2016
Ethiopia	10.2%	7.4%	Mozambique	6.7%	3.6%
Myanmar	8.4%	7.6%	Cambodia	6.6%	4.9%
Timor-Leste	7.8%	5.7%	Zambia	6.5%	3.4%
Lao PDR	7.7%	6.2%	DRC	6.4%	2.9%
Rwanda	7.6%	4.9%	Angola	6.3%	2.7%
Bhutan	7.6%	5.7%	Bangladesh	6.2%	5.0%
Afghanistan	7.2%	4.1%	Uganda	6.1%	2.6%
Tanzania	6.7%	3.4%			

The fastest growing least developed countries, except Rwanda, Bhutan and Zambia, are low ranked in the World Bank Group Flagship Report Doing Business 2018. The most favourable environment for business start-ups and entrepreneurs has been created in Rwanda. The country ranks the 41st out of 190 in the report. Rwanda is the second (after Mauritius) highest ranked country in Africa. The second country in the group of the fastest growing LDCs which has the most business-friendly regulations is Bhutan. The Bhutanese government has been one of the most active in South Asia in implementing reforms and simplifying the procedures necessary for business establishment (Nowak, 2017b, p. 152). The third business-friendly economy in the analysed group of LDCs is the Zambian one. Zambia is also the seventh highest ranked country in Africa. On the other hand, Afghanistan and Democratic Republic of the Congo are ranked among the bottom ten countries in the ranking on the ease of doing business (Table 2).

*Table 2: Ease of Doing Business Index in the fastest growing LDCs, June 1, 2017 (Source: WB, 2018)*

Country	Rank	Score	Country	Rank	Score
Afghanistan	183	36.19	Mozambique	138	54.00
Angola	175	41.49	Myanmar	171	44.21
Bangladesh	177	40.99	Rwanda	41	73.40
Bhutan	75	66.27	Tanzania	137	54.04
Cambodia	135	54.47	Timor-Leste	178	40.62
DRC	182	37.65	Uganda	122	56.94
Ethiopia	161	47.77	Zambia	85	64.50
Lao PDR	141	53.01			

In the years 2009-2017, the biggest increase in the Ease of Doing Business Index (EDB) was observed in Rwanda, Bhutan, Uganda, DRC, and Zambia. Over the shorter period from 2013 to 2017, Bhutan, Uganda, Rwanda, and Zambia improved the most their EDB indicators. The fastest growing least developed countries are doing the best in the areas of getting credit and paying taxes. Getting credit measures the strength of credit reporting systems and the effectiveness of collateral and bankruptcy laws in facilitating lending in a given country. The paying taxes indicator records the taxes and mandatory contributions that medium-sized limited liability companies must pay (WB, 2018). The easiest access to credit is in Zambia (the second place in the ranking on the ease of getting credit), Rwanda (the 6th), and Cambodia (the 20th). In the area of paying taxes Zambia takes the 15th place, Bhutan comes in the seventeenth, and Rwanda is the 31st. In the years 2008-2017, Rwanda, followed by Afghanistan, Zambia, and Lao PDR, made the greatest progress in the area of getting credit and Zambia, Angola, and Rwanda in paying taxes. On the other hand, the analysed countries have the biggest problem in the areas of opening a business and getting electricity. The starting a business indicator measures number of procedures, time, cost and paid-in minimum capital requirement for small and medium-sized limited liability companies to start up and formally operated in the largest business city of a given country. The companies are 100% domestically owned and employ between 10 and 50 people all of whom are domestic nationals. The getting electricity indicator studies procedures, time and cost required for a business to obtain a permanent electricity connection for a newly constructed warehouse (WB, 2018). DRC takes the 62nd place in the ranking on the ease of starting a business, Rwanda ranks the 78th out of 190, and Bhutan is ranked the 88th. Entrepreneurs face the least constraints in getting access to electricity in Bhutan (the 56th place), Tanzania (the 82nd), and Timor-Leste (the 114th). Between 2008 and 2017, DRC, Timor-Leste, and Angola made the greatest progress in the area of starting a business. Tanzania, followed by Bhutan and Cambodia, recorded the biggest increase in the level of the getting electricity indicator in the group of the analysed LDCs. The smallest number of procedures to legally start and operate a company is in Afghanistan, DRC, and Timor-Leste. In Afghanistan there are three administrative procedures to follow and seven days are required for a new company to start its activities. In DRC and Timor-Leste four procedures are needed and they take seven and nine days, respectively. The bureaucracy in Rwanda (5 procedures, 4 days) is speedy compared with those of Lao PDR (8 procedures, 67 days) and Cambodia where it takes an average of 99 days to deal with 9 procedures (Figure 1). From 2008 to 2017, DRC cut the number of procedures required for starting a business by 10 and time by 125 days. Timor-Leste shortened time need to open a new company by 148 days (Table 3).

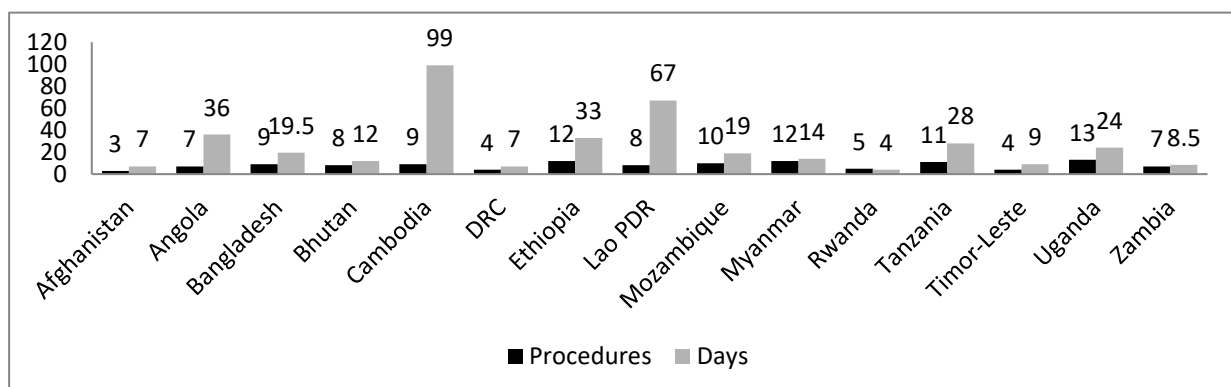


Figure 1: Number of procedures and days required to start a new business in the fastest growing LDCs, June 1, 2017 (Source: WB, 2018)

The analysed LDCs differ significantly in the cost of opening a new company. On June 1, 2017, starting a business in Timor-Leste required 0.5 per cent of what Timorese earned, on average

in a year. Three and half per cent of per capita gross national income were needed to start a new business in Lao PDR and 3.9 per cent in Bhutan. On the other hand, 51.3% of income per capita were required in Cambodia, 57.8% in Ethiopia, and 82.3% in Afghanistan. In the years 2008-2017, a few LDCs managed to reduce noticeably the cost of starting a new business. For instance, DRC recorded a nearly 907 percentage points decline (Table 3). Bhutan has very high score (80.36) for getting access to electricity compared to Bangladesh's score of 16.97. The number of procedures to obtain an electricity connection in the fastest growing LDCs ranges from a low of 3 in Timor-Leste to a high of 9 in Bangladesh. The countries differ considerably in the time required to get electricity. Rwandan entrepreneurs spend 34 days to get electricity while Bangladeshi can get a permanent electricity connection within 429 days. Besides, a significant variation in the cost of getting access to electricity has been observed across the analysed countries. Bhutanese have to spent 461% of per capita gross national income to get a new electricity connection while Congolese pay 14 886% of their GNI per capita (Figure 2).

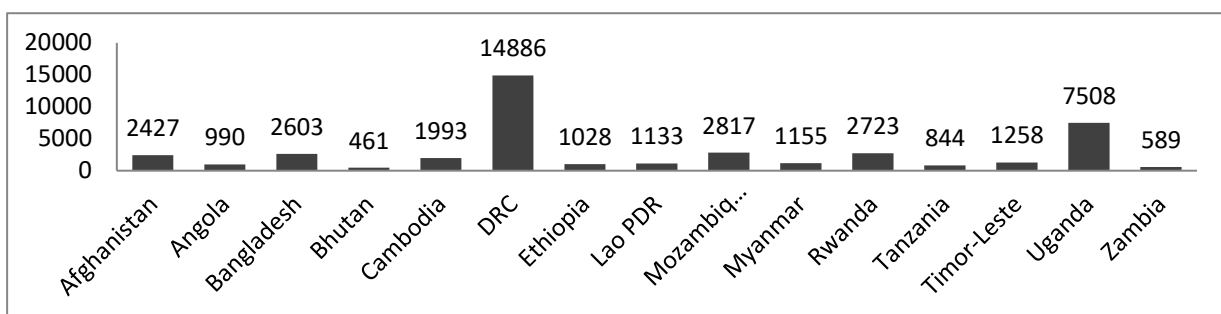


Figure 2: Cost of getting access to electricity (% of income per capita) in the fastest growing LDCs, June 1, 2017 (Source: WB, 2018)

During the analysed period, the fastest growing LDCs, except Uganda and Timor-Leste, decreased substantially the cost of getting electricity. The cost declined by more than 28 thousand percentage points in DRC and by more than three thousand percentage points in Ethiopia, Afghanistan, and Rwanda. Moreover, Afghanistan and Tanzania shortened time required to get electricity by 310 and 273 days, respectively (Table 3).

Table 3: Changes in the selected components of the Ease of Doing Business Index in the fastest growing LDCs, 2008-2017 (June 1) (Source: own calculations based on WB, 2018)

Country	Starting a business			Getting electricity (2009-2017)		Dealing with construction permits	
	Cost (% of GNI)	Procedures (number)	Time (days)	Cost (% of GNI)	Time (days)	Cost (% of warehouse value)	Time (days)
Afghanistan	+22.8	-1	-2	-3755	-310	-51.1	-4
Angola	-179.4	-1	-32	-108	-38	+0.3	-100
Bangladesh*	+3.5	0	-2	-1804	0	-1.7	0
Bhutan	-3.3	0	-34	-559	-32	-1.4	-1
Cambodia	-99.3	-2	-3	-1861	-15	+4.4	0
DRC	-906.8	-10	-125	-28092	-57	+6.2	-117
Ethiopia	+26.7	+1	+14	-3885	+20	-0.7	+7
Lao PDR	-8.1	-2	-18	-2141	0	-0.8	0
Mozambique	+5.5	-1	-14	-364	+7	-5.2	-124
Myanmar*	-117.6	-3	-63	-2215	-21	-4.0	0
Rwanda	-64.3	-3	-10	-3511	0	-4.6	-65
Tanzania	-94.3	-1	-3	-2017	-273	-7.2	-32
Timor-Leste	-6.4	-7	-148	+26	+54	-0.1	0
Uganda	-67.1	-4	-3	+487	-84	-18.1	-23
Zambia	+5.6	0	-10.5	-610	0	-4.8	-18

\* Data for Bangladesh cover the period 2013-2017 and for Myanmar 2012-2017.

In the area of dealing with construction permits, Lao PDR is ranked the 40th out of 190 countries, Mozambique ranks the 56th and Zambia is the 69th. Dealing with construction permits informs about number of procedures, time and cost to complete all formalities to build a warehouse. The indicator examines also the quality control and safety mechanisms in the construction permitting system (WB, 2018). The fastest growing LDCs differ principally in the time and number of procedures to comply with formalities to build a warehouse. In Lao PDR the time required to complete all procedures is 83 days while in Afghanistan 354 days and 652 in Cambodia. The number of procedures ranges from 10 in Angola and Zambia to 24 in Tanzania. In the years 2008-2017, the most improved economies in the area of dealing with construction permits were Mozambique, Uganda, Tanzania, and Rwanda. Mozambique, DRC, and Angola reduced time for processing permit applications by 100 days or more (Table 3). The number, time and cost of procedures to legally transfer title on immovable property are the lowest in Rwanda. The country takes the 2nd place in the ranking on the ease of registering property. In Rwanda there are three administrative procedures to follow and seven days are required for transferring a property. In contrast to Rwanda, in Bangladesh 8 steps to transfer a property take 244 days and in Afghanistan 9 procedures take 250 days. Between 2008 and 2017, Rwanda and Angola made the greatest progress in the area of registering property. The time and cost associated with the logistical process of exporting and importing goods are the lowest in Rwanda. The country ranks the 87th in the ranking of economies on the ease of trading across borders. During the considered period, conditions for conducting international trade have improved the most in Rwanda, Zambia, Uganda, and Ethiopia. The time and cost for resolving a commercial dispute through a local first-instance court are the lowest in Bhutan. The country is ranked the 25th in the ranking of countries on the ease of enforcing contracts. In the group of the fastest growing LDCs, Tanzania (rank 58), Uganda (rank 64), Ethiopia (rank 68), and Rwanda (rank 65) have relatively high positions on the ease of enforcing contracts. The greatest progress in that area has been made by Uganda, DRC, and Timor-Leste. The fastest growing LDCs, except Rwanda, have serious problem with protecting minority investors. They are also low ranked in the ranking of economies on the ease of resolving insolvency. In the years 2008-2017, Rwanda (rank 78), Cambodia (rank 74), and Mozambique (rank 75) increased the most their resolving insolvency indicators.

### **3. SIMILARITIES AND DIFFERENCES IN DOING BUSINESS IN THE FASTEST GROWING LDCS**

The Wroclaw taxonomy method is used to establish similarities and differences in the evaluation of progress in doing business achieved by the studied countries. The method was invented by Wroclawian mathematicians: K. Florek, J. Łukaszewicz, J. Perkal, H. Steinhaus, and S. Zubrzycki (Florek et al., 1951) in the early 1950s. In the method, a set of  $N$  objects with  $n$  selected characteristics each is split into typological groups by means of the Wroclaw taxonomy graph. The objects are compared between themselves by using a measure of distance. After computing distances for all pairs of objects, the shortest distances are selected and such pairs are linked by the line segments. The smaller the distance the more similar are the objects. Each object (represented by a vertex in the graph) is connected with its nearest neighbour in the set. All objects are connected to single joint graph. The Wroclaw taxonomy graph can be branching but cannot contain closed chains. It is the shortest spanning tree. The form of the graph does not depend on the vertex one starts with. Then  $K$  groups of the most similar objects are formed. In order to do this,  $K-1$  longest links are removed from the graph. The number  $K$  can be calculated using various methods or determined by the researcher (Nowak, 2016, pp. 1377-1378). In our case, 150 objects are considered because the Ease of Doing Business Index is analysed in 15 fastest growing LDCs over the period from 2008 to 2017. Each country in a given year is characterised by the values of 10 sub-indicators of the EDB index. The Euclidean

metric is used to calculate the distance between each pair of the objects. Between 2008 and 2017, the biggest changes (measured by the Euclidean distance) in the evaluation of doing business were observed in Rwanda, Bhutan, Tanzania, Cambodia, and Zambia. Rwanda has been a leader in removing obstacles in business not only in the group of the fastest growing LDCs but in the world. It implemented 49 different reforms, of which 44 making it faster and easier to do business. Bhutan introduced 11 business reforms, Tanzania 16, of which 7 making it more difficult to do business, Cambodia implemented 12 reforms, of which 4 have worsened the business climate and Zambia 22 reforms (5 reforms making it more difficult to do business). In the group of the fastest growing LDCs, the shortest Euclidean distances were observed between Bhutan and Rwanda in the years 2009-2012, Tanzania and Uganda (2008-2010), Ethiopia and Tanzania (2013-2015), Mozambique and Myanmar (2015-2017), Zambia and Uganda (2015-2017), and Angola and DRC (2008-2017). Moreover, Zambia, Uganda, and Tanzania (2008-2010) and Mozambique, Uganda, and Tanzania (2011-2013) formed two groups of countries with the shortest Euclidean distances<sup>1</sup>. In the years 2009-2012, Bhutan and Rwanda achieved the most similar scores in the areas of paying taxes, enforcing contracts, and getting electricity. Tanzania and Uganda achieved the same scores in the area of getting credit in the years 2008-2010. What's more, they also recorded small differences in scores in the areas of registering property, starting a business, dealing with construction permits, and protecting minority investors. The shortest Euclidean distances between Ethiopia and Tanzania in the years 2013-2015 resulted mainly from similar scores achieved by the countries in the areas of getting electricity, registering property, and paying taxes. Zambia and Uganda were similarly evaluated by the World Bank in the areas of protecting minority investors, resolving insolvency, and registering property in the years 2015-2017. Mozambique and Myanmar achieved similar scores in the areas of dealing with construction permits, registering property, paying taxes, and enforcing contracts in the years 2015-2017. Over the considered period, Angola and DRC had the most similar scores in the areas of dealing with construction permits, registering property, and enforcing contracts. In general, the fastest growing least developed countries achieved the most similar scores first of all in the areas of registering property, dealing with construction permits, paying taxes, and enforcing contracts. The Euclidean distances between Timor-Leste and the other LDCs are the biggest.

#### 4. CONCLUSION

Between 2008 and 2017, Rwanda, Bhutan, and Zambia created the most favourable environment for business start-ups and entrepreneurs. In the group of the fastest growing least developed countries, Rwanda and Bhutan made the greatest progress in improving business climate. Rwanda was also the world leader in implementing business reforms. In the remaining fastest growing LDCs domestic firms still face very costly and time-consuming process. Generally, entrepreneurs in those countries have the biggest problem in the areas of starting a business and getting electricity. During the considered 10 years, Angola and Democratic Republic of the Congo created the most similar business regulatory environment. Small differences in the evaluation of doing business were also observed in Bhutan and Rwanda (2009-2012), Tanzania and Uganda (2008-2010), Ethiopia and Tanzania (2013-2015), Zambia and Uganda (2015-2017), and Mozambique and Myanmar (2015-2017). In the group of the analysed LDCs, Rwanda is the best example of a country which achieved high growth rates removing obstacles in business. Further improvement of the business environment may lead to greater economic growth in the fastest growing LDCs.

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<sup>1</sup> Because of a big number of the analysed objects the results are not presented in the form of Wroclaw taxonomy graph.



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## COURT SETTLEMENT AS A WAY OF DISPUTE RESOLUTION AND THE PRINCIPLE OF JUDICIAL EFFICIENCY

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### **ABSTRACT**

*A court settlement is a manifestation of state compulsion, according to which parties are not permitted to resolve disputes between them by themselves but this can and shall be done solely by the state or in this case, court as a governmental body. Parties can enter into an out-of-court settlement to resolve disputes between them, but only within a framework set forth by the state. A court or out-of-court settlement appears as a tool only in modern states which centralize the political power, keeping it away from other parties. One of the basic effects of a court settlement is effectiveness. Effectiveness is an instrument aimed at realizing a specific legal value – legal certainty. Furthermore, a court settlement is intended for the accomplishment of another legal goal – peace. While being an alternative to the mediation procedure itself, a court settlement is primarily an alternative way of dispute resolution. A court settlement (res judicaliter transacta) is based on an agreement that regulates the civil-law relations between the parties, implies the effects of an effective judgment and is concluded before the competent court in writing in either contentious or non-contentious proceedings. Due to the fact that a court settlement entails the effects of an effective court decision, it can be subject to some principles of ordinary court proceedings. However, one principle can be applied in its full scope – the principle of judicial efficiency. It requires from court proceedings to be as cost-effective and short as possible. If a court settlement is concluded prior to the initiation of ordinary court proceeding and the latter is thus prevented, it will come to the greatest possible cost- and time-saving. If the proceeding is initiated, but a court settlement is reached in the meanwhile, the costs and course of the proceedings will be reduced to a certain level. The paper has the following structure: after a brief introduction elaborating the concept, legal nature and scope of a court settlement, the main part analyses its effects, putting the emphasis both on effectiveness as an instrument for ensuring legal certainty and peace, and on the principle of judicial efficiency as a top priority principle incorporated in the court settlement concept.*

**Keywords:** *alternative dispute resolution, court settlement, effectiveness, legal certainty, principle of judicial efficiency*

### **1. INTRODUCTION**

A court settlement is a notion originating from both procedural and substantive law. The main effect of a court settlement in procedural law refers to the fact that it has the same effect as a valid final judgment (res iudicata) and that no legal action can be instituted twice for the same cause of action (ne bis in idem). In substantive law, this concept has a broader meaning and reveals the fundamental legal values of the legal state – peace and legal security. Reaching a court settlement presupposes peace building as the elementary or primary value of a legal order. The essence of peace relates to the prevention of the private violence of one subject who monopolizes physical compulsion – that is the state, and such compulsion is exercised through courts, whereas others can use it only exceptionally such as in situations involving permitted self-help, self-protection or self-defence. Peace comes from legal certainty which revolves

around two aspects: predictability which comes into existence when subjects of legal norms comprehend them fully, are aware of their rights and obligations arising from those norms and are familiar with the fact that the requirements contained therein are supposed to be in effect permanently (Visković, 2006, p. 148), and certainty that relates to the exercise of the rights and obligations set forth in legal norms, which means that the existing legal norms are respected and implemented. Like every law-regulated instrument implies realization of a certain level of legal certainty and a guarantee that controversial rights and obligations will be exercised, a court settlement leans on effectiveness. The values of legal certainty are opposed to the values of justice and righteousness, and in this conflict, the former values prevail. Moreover, it needs to be pointed out that the guiding light for the introduction of the court settlement concept is the principle of efficiency, which enables avoidance of ordinary proceedings or if such has been instituted, its suspension as soon as a court settlement is reached, which reduces judicial fees to a certain extent. The paper promotes some universal features of this concept and neglects some of its characteristics typical for particular legal systems. The concept is viewed from the perspective of continental law since a court settlement has a different meaning in common law. Due to the fact that effectiveness entails legal remedies, the paper also tackles the possibility of contesting a court settlement. This possibility depends on the formulation of an adopted concept.

## **2. GENERAL ON A COURT SETTLEMENT**

### **2.1. Concept**

In the relevant literature, a court settlement (*res judicialiter transacta*) is defined as “an agreement between the parties, aimed at regulation of their relations which are not bound by any other relation, and concluded in writing before the competent court that permits it in either contentious or non-contentious proceedings, and has the capacity of a valid final judgement and, if stipulating an obligation for a performance, the capacity of an enforcement order.” (Triva, Dika, 2004, str. 570). More precisely, it is denoted as “an agreement between all or some of the parties and/or possible third parties, made based on a (implicit) court’s approval during contentious (contentious court settlement) or some other court proceedings (non-contentious court proceedings) by signing the protocol containing the agreement, and aimed at full or partial regulation of the relations between the signatories in regard to and/or due to the dispute, and such an agreement may imply the (some) effects of a valid final judgement and, if stipulating an obligation for a performance, the capacity of an enforcement order.” (Dika, 2013, p. 515).

### **2.2. Ratio**

A court settlement is a form of an amicable resolution of a dispute on the existence or non-existence of a right or legal relation, or amicably overcoming disputable situations between persons concluding it; however, even if there is no dispute between the parties on the content of their rights, a court settlement may redefine their existing relation or establish a new one implying effects of a valid final judgement or an enforcement order (Dika, 2013, p. 520). A court settlement is aimed at discontinuing a legal action or preventing its initiation, and its conclusion relieves the parties from seeking judicial protection. Consequently, it is in the legislator’s interest to facilitate an amicable resolution of disputes. (Triva, Dika, 2004, p. 570). Since a court settlement makes further legal action needless, the parties to the dispute do not have to prove their legal interest in concluding the settlement. (Triva, Dika, 2004, p. 570). A court settlement enables the parties, among other things, to avoid litigation followed by the deterioration of mutual relations, to obtain an enforcement order and spend less funds than in ordinary proceedings, and to prevent further legal action and deterioration of mutual relations (Dika, 2013, p. 520). The aforementioned suggests that court settlements may substantially shorten court proceedings and thus disburden courts.

From a broader social perspective, court settlements soften the tensions between subjects, decrease the workload of courts, diminish the need for conducting other proceedings such as court enforcement proceedings and similar (Dika, 2013, str. 520). Beside the above benefits of court settlements, the relevant literature warns about potential dangers of court settlements: judges may insist on settlement conclusion with the aim to simplify the proceedings, which might represent a form of coercion for the purpose of releasing them from the obligation of passing a judgement and hence, from challenging their impartiality (Dika, 2013, p. 520-521). However, taking into account that the parties, if opting for a settlement, prudently evaluate it in advance, its potential flaws can hardly represent any great danger.

### **2.3. Scope and Content**

In the Republic of Croatia, a court settlement is regulated by the Civil Procedure Act (hereinafter: CPA) or more precisely, by its Title 22 having the same name as this paper (Articles 321-324). At any time during proceedings before the first-instance court handling the litigation, the parties may reach a settlement about the matter of controversy (a court settlement). A settlement may also be reached during the proceedings before the second instance court until it makes a decision on the appeal (Article 321 paragraph 1 of the CPA). The settlement may refer to the whole claim or a part thereof (Article 321 paragraph 2 of the CPA). During the proceedings, the court shall inform the parties on the possibility of reaching a settlement and the court shall assist them to reach it (Article 321 paragraph 3 of the CPA), which excludes the permissibility of the pressure from the court on the parties to reach a settlement (Jakšić, 2017, p. 599). The parties' agreement about the settlement shall be incorporated into the protocol (Article 322 paragraph 2 of the CPA) and an agreement about the settlement is reached when the parties sign the protocol after such a protocol have been read to them (Article 322 paragraph 2 of the CPA). During the whole proceedings, the court shall *sua sponte* pay attention to whether legal action is pending about a matter that has previously been subject to a court settlement. If the court establishes that a court settlement has already been reached on the matter about which the legal action is pending, it shall dismiss the appeal (Article 323 of the CPA). As far as the subject matter of a court settlement is concerned, the parties may only freely dispose of the claims put forward by them in the proceedings, such as those regulated by dispositive regulations (Triva, Dika, 2004, p. 572, Article 3 paragraph 3 of the CPA). The requirements for the admissibility of a court settlement are as follows: (1) court's competence, (2) proper court constitution; (3) parties' ability; (4) legal interest in the conclusion of an agreement in the form of a court settlement; (5) admissibility of the subject matter and (6) prescribed form of the agreement on a court settlement. (Triva, Dika, 2004, p. 570).

### **2.4. Legal Nature**

A court settlement is an agreement regulated by civil law and procedural action of the parties (Vojković, 2002, p 51.) as well as procedural action of the court since it shall approve of the settlement, incorporate it into the protocol and thus permit the parties to conclude and sign it in order to provide it with a legal force (Dika, 2013, p. 527). The Austrian and German doctrine, as stated by Dika, propagate three basic perceptions of the legal nature of a court settlement and three variants of those perceptions: (1) the so-called substantive law theory, according to which a court settlement does not differentiate much from a private settlement, (2) the so-called pure procedural theory, according to which a court settlement is an independent procedural agreement reached with assistance of the court (3) the court settlement theory as bifunctional legal action, according to which a court settlement has the role of a legal action and civil law contract (Dika, 2013, pp. 529-532). A court settlement is an agreement of heterogeneous nature, so it should be perceived as such (in the sense of its admissibility and validity) from the perception of both procedural and substantive civil law (Triva, Dika, 2004, pp. 570 and 573).

In fact, the prevailing conception is the third one, pursuant to which a court settlement assumes the role of a legal action and civil law contract. A court settlement has the capacity of a valid final judgement and can only be unconditional (Triva, Dika, 2004, p. 573). In line with its nature, a court settlement resembles a judgement based on admission of the claim and a judgment based on waiver of the claim (Triva, Dika, 2004, p. 576.)

### **3. OUT-OF-COURT SETTLEMENT**

An out-of-court settlement or a settlement as a substantive civil law concept is governed by the Civil Obligations Act (hereinafter: COA) or more precisely, by its Articles 150-159. (Vojković, 2002 p. 50) Pursuant to Article 150 of the COA, an out-of-court settlement is a settlement agreement between persons involved in a dispute or dealing with uncertainty in a legal relation, who, by compromise, discontinue the dispute or eliminate the uncertainty and regulate their rights and liabilities. By its nature, a settlement is a bilateral agreement for pecuniary interest, which is subject to the relevant provisions of the law of obligations (Pavlović, 2005, p. 10). In that light, an out-of-court settlement requires no assistance of the court which, on the contrary, plays an important role in the conclusion of a court settlement. Also, it does not have the effect as a valid legal judgment or the capacity of an enforcement order (Jakšić, 2017, p. 595).

### **4. COURT SETTLEMENT AS AN ALTERNATIVE WAY OF DISPUTE RESOLUTION**

#### **4.1. Court Settlement as an Alternative to the Judicial Decision**

Since it reflects the autonomous will of the parties, a court settlement is compliant with the dispositive nature of legal action and it is thus encouraged by the legislator (Article 321 para 3), by ordering the court to inform the parties about the possibility of reaching a settlement and provide them with assistance in the conclusion of a settlement for the reasons stated in 2.2. (Dika, 2013, pp. 523-524.), which may, in the essence, be reduced to only one of them – efficiency (more details in 4.1.).

#### **4.2. Court Settlement and Mediation**

Mediation can be defined as “any process, whether conducted in court, by a mediation organization or out of court, whereby parties attempt to resolve a dispute in an amicable manner with the assistance of one or more mediators who help the disputants reach an amicable settlement without being authorized to impose an obligatory resolution” (Mediation Act, Article 3). Mediation is conducted by mediators based on an agreement of the parties (Mediation Act, Article 3). During the process of reaching a court settlement, the role of the judge is not the same as that of the mediator in the mediation procedure and the court is entitled to perform only those actions which involve both parties. Unlike a judge, a mediator may meet with each of the parties separately and may disclose information or details received from one party to another party only upon consent of the disclosing party (Mediation Act, Article 10 paragraphs 1 and 2). This discloses the main difference between these two procedures – a court settlement entails contradiction (Dika, 2013, p. 525). Contradiction when entering into a court settlement is a necessary consequence of the perception of the role of the judge as a party who does not actively participate in the process of court settlement conclusion since this may disturb the objectivity and equality of the parties whereas in terms of mediation, a mediator is supposed to persuade the parties to reach an agreement, so he/she has the main role in the mediation procedure.

## **5. EFFECTS OF A COURT SETTLEMENT**

### **5.1. Principle of Efficiency**

Since conclusion of a court settlement implies the effects of a valid final judgement, some principles of ordinary court (contentious) proceedings may, though restrictively, apply to a court settlement. However, one principle can be applied to its full extent – the principle of efficiency. It requires that from court proceedings to be as cost-effective and short as possible (see Jakšić, 2017, p. 216). If a court settlement is concluded prior to the initiation of ordinary court proceeding and the latter is thus prevented, it will come to the greatest possible cost- and time-saving. If the proceeding is initiated, but a court settlement is reached in the meanwhile, the costs and course of the proceedings will be reduced to a certain level. Economical handling of proceedings implies that the costs of proceedings shall never exceed the value of the interest, due to which the legal action was initiated in the first place (Triva, Dika, 2004, p. 145). The protection or the exercise of subjective rights, provided within proceedings, shall be ensured within a reasonable period of time in order to have the real value (Galič, 2013, p. 808). This applies to an ordinary civil lawsuit and hence, it can be applied to a court settlement too. In the context of the aforementioned comparison of a court settlement with a judgement based on admission of the claim and on waiver of the claim, one can say that a court settlement is the more efficient protection instrument (Vojković, 2002, p. 51). In ordinary court proceedings, the principle of efficiency may come into conflict with the truth-seeking principle. Beside the conflict of two principles, there is a conflict of the two legal values realized through these principles: the principle of efficiency contributes to the achievement of legal security and the truth-seeking principle to justice (righteousness); therefore, legal security comes into conflict with righteousness. When trying to reach a court settlement, it comes to petty or no application of the truth-seeking principle and even lower probability of achieving righteousness: the fact that the proceedings has been discontinued by concluding a settlement, does not necessarily mean that the outcome is just. Indeed, in this conflict between legal values, legal security prevails: it is better for proceedings to be discontinued than to last indefinitely. This is even more important when a dispute is resolved by a court settlement prior to initiation of court proceedings. Yet, there is a hidden danger: in situations in which the parties can choose between the possibility of prompt resolution of a legal relation (in the form of a court settlement) or starting long lasting court proceedings, they are likely to opt for the court settlement, particularly if the issue concerns a considerable pecuniary amount. The parties often consider that it is better to take a smaller amount than to start court proceedings since who knows when the proceedings will be adjourned and what can happen in the meanwhile. If opting for a court settlement, one party can get much less than he/she would get in case of court proceedings. This should be taken into account when a dispute involves an ignorant and/or a financially weak party.

### **5.2. Peace**

Reaching a court settlement presupposes peace building as the elementary or primary value of a legal order. A person who believes that one of his/her rights has been violated is entitled to protect it and request its exercise before court and accordingly, to enter into a court settlement. The essence of peace relates to the prevention of the private violence of one subject who monopolizes physical compulsion (Visković, 2006, p. 143). That subject is the state and the army and police are the only ones who can directly use compulsion whereas others can utilize it only exceptionally such as in the event of self-defence (Pavčnik, 2015, p. 507). Hence, peace cannot be achieved without organized legal violence of the authorities against those who commit violence illegally (Visković, 2006, p. 146). In that sense, Kelsen's assertion that law brings only relative peace seems to be right since it deprives individuals of the licence to use

force but entitles a society to do so (Kelsen, 1951, str. 35). Therefore, absolute peace is an ideal condition which cannot be accomplished in a state (Pavčnik, 2015, p. 508).

### 5.3. Legal Certainty

Peace represents a requirement for another legal value – legal certainty. Legal certainty implies two aspects: predictability which comes into existence when subjects of legal norms comprehend them fully, are aware of their rights and obligations arising from those norms and are familiar with the fact that the requirements contained therein are supposed to be in effect permanently (Visković, 2006., str. 147), and certainty that relates to the exercise of the rights and obligations set forth in legal norms, which means that the existing legal norms are respected and implemented. It can be said that people rightly expect from the state to use compulsion to ensure their maximum legal protection (Aarnio, 2011, str. 20). Legal certainty is guaranteed by the parliamentary law adoption procedure which guarantees by its complexity and length that the reasons for adoption of a future law have been thoroughly discussed and represent the will of constituency. That is why legal certainty requires from a legal system to include no legal lacunae or only insignificant ones (Pavčnik, 2015, p. 524). Legal security is deemed as a dimension of “the Welfare State” (Aarnio, 2011, p. 118). Like every law-based concept entails achievement of a particular level of legal security and a guarantee that controversial rights and obligations will be exercised, a court settlement relies on the instrument of effectiveness. There is neither absolute legal certainty nor an absolute law (Pavčnik, 2015, p. 525). The need for legal security can be jeopardized by frequent and inappropriate amendments of legal norms, their incompleteness or retroactive effect or a failure to implement them or their long and inappropriate implementation. Besides, as stated hereinabove, legal security may be confronted with justice. While legal security requires substantiality of rules, positive regulations impose themselves regardless of their righteousness (Radbruch, 1980, pp. 95 and 97).

### 5.4. Effectiveness – *res iudicata*

As mentioned hereinabove, effectiveness is an instrument for legal security, but also a product of a court settlement. It affects all the main types of proceedings – civil, criminal and administrative procedure. Effectiveness is one of the features of judgements or decrees, stipulating that they have become legally binding and cannot be remedied any more (Triva, Dika, 2004, p. 629; Visković, 2006, p. 223, Pravni Leksikon, 2007, p. 1235). *Res iudicata* is the Latin term denoting that a dispute has been concluded with a valid final judgment, prohibiting that a legal action is instituted twice for the same cause of action based on the *ne bis in idem* principle (<http://proleksis.lzmk.hr/43760/>). This rule results from a lack of a legal interest of the parties to initiate new proceedings since due to the maintenance of legal certainty, it shall not be ruled other than in the original judgement. Since it shall not be adjudicated differently, it makes no sense to institute new proceedings (Triva, Dika, 2004, p. 632). Nevertheless, even valid final judgments and decrees can be subject to special legal remedies. After expiration of the deadline for lodging special appeals or their rejection, a judgement or decree becomes absolutely effective (Visković, 2006, p. 223). Unlike regular legal remedies, which are, in principle, filed against all kinds of factual and legal errors, special legal remedies are utilized only for some reasons explicitly laid down in the law, e.g. revelation of important facts which were not known at the time of judgement delivery and can substantially affect the judgement – application to reopen a case, or for severe violation of the law – application for the protection of legality (Visković, 2006, p. 223). To sum up, law permits filing appeals against valid final judgements since it may happen that final judgements are illegal and substantially irregular (Pavčnik, 2015, p. 362). The issue of effectiveness is one of the theoretically most controversial issues in civil procedural law (Dika, 2013, p. 386). Despite different and even opposing attitudes in legal dogmatism pertaining to the essence of effectiveness, it is possible to establish several

basic approaches to the issue (Dika, 2013, p. 386). In legal science, no matter if German, Austrian, Italian or Croatian – the predominant standpoint is the traditionalistic one which starts from the thesis that a judicial decision is a declaratory act (Dika, 2013, p. 386). The aforementioned doctrines applied in the definition of effectiveness are rooted in the differentiation between formal and substantive effectiveness: the first one is defined as the incontestability of a judgement by (ordinary) legal remedies and the second one as a specific effect of a judgement which content and legal nature are perceived differently, depending on the inclination to civil or procedural law theories (Dika, 2013, p. 387). In the latter case, the emphasis is put on the so-called substantive effectiveness which is derived from the so-called formal effectiveness. For valid individual legal acts, such as a court settlement, it is said that they possess some properties of legal truth. Legal truth is not the same as scientific truth which can be contested by anyone, but it is ultimate, disputed and dogmatic truth pronounced by a government body within a special (legal) procedure, with an emphasis on legal security: in terms of the predictability of human behaviour, it is necessary to put an end, at one moment, to the discussion about who is right; after spending some time on a guided discussion, the government body closes it and then comes the principle *res iudicata pro veritate habetur* – an adjudicated thing is regarded as the truth. Consequently, it may happen that erroneous and unjust judgements can be contested by neither regular nor special legal remedies (Visković, 2006, p. 224). Indeed, with respect to effectiveness, legal security always prevails over justice and other values. It would be utopic for a legal system to always put justice before legal security (Cappelletty, Merryman, Perillo, 1967, p. 157). Regarding the moment when a judgment turns into *res iudicata*, there is a traditional contradiction between civil law and common law systems. Let us note that common law is familiar with the *res iudicata* doctrine which could be explained as follows: courts have the power to create precedents and set general rules, to issue orders to individuals, to perform certain action and to authoritatively establish facts in a case (Raz, 2009, str. 110). The prevailing view in American law is that a final judgment starts being regarded as *res iudicata* as soon as it is entered and the possibility of contesting it is restricted (Cappelletty, Merryman, Perillo, 1967, p. 156). Let us now elaborate the issue of the relation between the effectiveness of a court settlement and legal remedies. Namely, if a court settlement is valid and effective, analogously it should be deemed as if it should not be subject to an appeal. Moreover, it should not be subject to special legal remedies either. The authors hold that due to the danger of a concluded court settlement relating to the ignorance of the parties, there must be a possibility to contest the settlement at least on one instance. How to call these instruments, what reasons could bring to the contestation of a court settlement and what could be the appertaining deadlines? The authors believe that the legislator should deal with these issues *de lege ferenda* and they should depend on the legal nature of a court settlement; is it assumed that the nature of court settlements relates to substantive law or court settlements represent legal action, the effects of which are analogous to those of a valid final judgement (Dika, 2013, p. 609). In the end, let us repeat that a court settlement has the capacity of an effective judgement (Dika, 2013, p. 592 and beyond) and cannot imply repeated institution of proceedings for the same cause of action. If courts were not bound, they could resolve the same legal issue differently, which would challenge adjudication logic and legal security (*ne variae iudicetur*) (Dika, 2013, p. 596).

## 6. CONCLUSION

The main effect of a court settlement in procedural law refers to the fact that it has the same effect as a valid final judgment (*res iudicata*) (Dika, 2013, p. 592 and further) and that no legal action can be instituted twice for the same cause of action (*ne bis in idem*), which is also typical for a valid final judgement. If courts were not bound, they could resolve the same legal issue differently, which would challenge adjudication logic and legal security – *ne variae iudicetur*



(Dika, 2013, str. 596). Apart from legal security appearing when subjects of legal norms are familiar with their rights and obligations and when it is certain that they will be able to exercise them, conclusion of a court settlement entails realization of another legal value – peace or in other words, monopolization of physical compulsion by the state or in this context, the court, and only exceptionally by other subjects such as in situations involving permitted self-help, self-protection or self-defence. The main aim of a court settlement – the principle of efficiency is confronted with the truth-seeking principle and thus the legal values supporting those principles also come into conflict with each other – these are legal security and justice (righteousness). What dominates in this conflict is legal security.

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## EU CONSUMER PROTECTION ISSUES REGARDING PAYMENT PROTECTION INSURANCE

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### ABSTRACT

*Taking as a base the historical origins and sources of payment protection insurance (PPI) policy as a specific contractual clause included in credit agreements, the authors analyse the role of the insurance provider in the protection of property and personal income of the credit negotiator upon the emergence of certain risks (accident, sickness and unemployment) which cause insolvency, i.e. inability to repay credit. Stressing the importance of obtaining the PPI cover which, for a certain period, provides to the credit negotiator protection in a situation when the payment of credit is impossible, the authors draw attention to the relevance of this topic while underlining the open legal issues of misselling of that financial product and its effects (financial mis-selling) and obtaining the abovementioned insurance cover for credit negotiators who have ended up with financial product which is not in their interests. While as much as 40% of consumers were unaware that they had an insurance policy, their trust in financial institutions was permanently undermined. Since PPI mis-selling practices are a key concern for consumers, an important part of financial market, an increasing number of claims against mis-selling of PPI policies (a claim to the bank, lender or broker who sold the PPI policy) highlighted the need to change the unfair terms in PPI policy and define the legal and insurance status of that financial product. To this end, the authors analyse the provisions of the judgement of the Court of Great Britain, Royal Courts of Justice in Case CO/10619/2010 from April 20, 2011 and the consequences of its implementation, i.e. the duty of banks and other financial institutions to compensate the damage caused to consumers by the financial mis-sold PPI. In addition, the authors examine the fairness of a PPI policy under EU consumer law according to the latest provisions of the European Court of Justice (ECJ) in Case C-96/14.*

**Keywords:** *EU consumer protection, payment protection insurance*

### 1. INTRODUCTION

In the global financial services market over 150 million new financial services consumers emerge annually (Pauković, 2013, p.83). Consumer credit is one of the most significant financial services in modern economies (Dukić Mijatović; Gongeta, 2014, p. 410) and important role in EU economy. Consumer credit contract is a bilateral contract concluded between the contracting parties (borrower and credit provider) under which the parties undertake to duly fulfil their financial obligations. By analysing the contractual clause concerning the insurance against inability to repay credit which provides protection against customers insolvency, bankruptcy and non-payment (which is an integral part of a credit contract), the authors analyse consumer protection issues regarding Payment Protection Insurance (PPI). As a new insurance product in financial services, PPI provide insurance coverage for the consumer of a financial obligation in case they are unable (because of accident, sickness or unemployment) to fulfil a payment, i.e. when borrowers are unable to fulfil their financial obligations due to the reduction of liquidity, that is, due to their insolvency. This type of property insurance (non life-insurance) is used to insure the debtor's assets by protecting

them, for a certain period of time, from a possible impairment of assets in the case one-off payment of higher amounts in settlement of credit debt. By taking PPI consumers can defuse the financial risks of credit default (Raynard; Mchugh, 2012, p.738). In theory, PPI is a useful product (Lowe, 2015, p.1) which serve legitimate consumer needs to ensure the recovery of claims and, in the alternative, to protect the debtor from inability to repay credit. However, insurance cover is not granted on the basis of the ability to repay credit but on the basis of solvency – insurer's liquidity (Belanić, 2012, p.76). In this paper the authors put forward the European dimension of fairness of a PPI policy under EU consumer law.

## **2. FINANCIAL MIS-SELLING OF THE PPI POLICIES**

PPI was distributed through consumer credit providers (banks and other financial institutions). PPI was a product widely distributed as an add-on to each and every consumer creditor and was understood as a protection in case of situations when the payment of credit was impossible (Więcko-Tulowiecka, 2017, p.61). Practice has showed some negative effect of PPI in relation to issues on consumer protection while credit providers requested from consumers (in signing a credit agreement with a financial institution a person became a credit institutions' customer, i.e. a consumer of financial services) to sign PPI to get credit. More precisely, PPI was generally distributed together with a credit product (Background Note on Payment Protection Insurance, 2013, p.7) which was the primary product for the consumer (Opinion on Payment Protection Insurance, 2013, p.2). As a consumer credit insurance, PPI is a voluntary insurance. But, very often the granting of consumer credit was not possible without accepting at the same time the contractual clause on PPI and consumers considered it to be a compulsory insurance. More precisely, some borrowers were not told that PPI was included in the package, and assumed that their payment was purely related to the loan; others were told that PPI was compulsory; and members of a third group purchased PPI cover even though they could never make a claim under it, for example if they were self-employed (Merkin; Steele, 2013, p. 90). In granting credit, the credit providers perform a credit analysis of the applicant for credit, credit risk assessment and creditworthiness assessment since credit placements generate the most revenue for credit providers. The credit placements are also the highest risk for banks especially in the case of a global financial crisis and a compromised economic and financial stability of the beneficiary. In a difficult financial situation, the client of credit and financial institutions not only accepts all the terms of the contract, but generally without giving them any consideration, hastily concludes the contract and thus, not taking into account the severity of long-term consequences, solves the current problem of lack of financial resources (Mišćenić, 2013, p.125). The lack of real choice, the lack of knowledge and the fact that the average consumer does not usually try to familiarise with all the elements of the contract, unfortunately often lead to the author of the contract imposing clauses that are unfavorable to the applicant (Petrić, 2013, p.21). Although the primary purpose of the PPI was to protect the borrower's assets from contingencies arisen from the insurance contract, due to the way in which the PPI was taken out and the lack of awareness of the borrower, the benefits of that financial product were most often on the creditors' side – credit providers. Consequently, selling PPI became a huge and profitable market for financial institution and began to be sold massively (Więcko-Tulowiecka, 2017, p.62). These were bad sales practices in financial services (mis-selling) which the Financial Services Authority (FSA) in 2013 defined as “a failure to deliver fair outcomes for consumers” (Financial Services Authority, 2013, p. 9). These outcomes include: a) customers are treated fairly; b) customers understand the key features of the product or service and whether they are being given advice or information; c) customers are given information that is clear, fair and not misleading – information that enables them to make an informed decision before purchasing a product or service or before trading; and d) customers buying on an advised basis are recommended suitable products (Financial Services Authority, 2013, p. 9).

According to European Insurance and Occupational Pensions Authority (EIOPA), challenges related to consumer protection in the area of PPI are: a) PPI products are often not suitable for the consumer they have been sold to; b) Consumers are not free to choose the products they like (examples: payment protection products are often sold together with loan products, the insurance contract is part of a group insurance contract, providers often don't include essential information about the product characteristics or there are limitations in coverage etc.); c) Consumers often lack information that would be tailored to their needs or find the information too complex for making informed choices (What has EIOPA done recently in the area of consumer protection?, 2018, p.1). Precisely the practice of mis-selling PPI policies has resulted in violation of consumer rights of insured persons. To be more exact, PPI is not suitable for everyone (Georgosouli, 2014, p.263) and mis-selling exists when a financial adviser recommends that a customer purchase a portfolio of products that is unsuitable for their particular circumstances (Financial Conduct Authority and Financial Ombudsman Service, 2016, p.14). Examples of mis-selling PPI policies are: where a consumer didn't realise they were taking out a policy (and didn't actually want one); the policy wasn't properly described to them and they brought it not understanding how it worked or how it wasn't suitable for them (Financial Ombudsman Service, 2014, p.1). The consumer, as a party to the credit agreement, very often did not have the right to choose whether or not to take out PPI as a means of securing the credit. To be more exact, the underwriting of PPI policy came from the signing of standard credit agreement, a PPI product constituted a contractual clause of the credit agreement. Many consumers therefore end up with products that are not in their interest e.g., not needed or too expensive (Mak; Braspenning, 2012, p.314). Those kind of PPI mis-selling practices were a key concern for consumers. As a result of such practices, banks and other credit providers were required to compensate customers who were mis-sold PPI. During 2011 alone, the industry paid out around £1.9 billion by way of redress to consumers who were mis-sold PPI (Ferran, 2012, p.249) and between April 2011 and November 2015 - £22.2bn (Financial Conduct Authority and Financial Ombudsman Service, 2016, p.4). A total of £366.9m was paid in November 2017 to customers who complained about the way they were sold PPI taking the amount paid since January 2011 to £29.6bn (Financial Conduct Authority, 2018, p.1). Naturally, it is an amount that will unquestionably grow in the future in view of the deadline by when consumers need to make their PPI complaints – 29 August 2019.

### **2.1. Mis-selling of PPI policies in UK – Royal Courts of Justice, Case BBA v FSA&FOS from 2011.**

As the authors have stated above, this type of insurance (PPI) has generated large profits for the financial institutions. Nevertheless, a major criticism of PPI, a new financial and insurance product, in no way relates to large profits that these financial institutions realised as a result of underwriting of PPI policies as contractual clauses that were an integral part of a credit agreement. The criticism relates to the fact that the basic problems concerning PPI were the impossibility to change this contractual clause or to withdraw from implementing it in the credit agreement since it was a standard contract, i.e. an adhesion contract that is concluded on a “take it or leave it” basis. Consequently, the consumers were victims of systemic and widespread mis-selling by all the major retail banks of PPI (Money-Kyrle, 2016, p.250). Problems in the financial market were highlighted by numerous reports regarding the illegality of PPI sales. In 2005, the FSA was aware that traders, when underwriting PPI as a secondary product, were not convinced that the product in question was truly beneficial to consumers, since in most cases this PPI policy did not provide insurance coverage to consumers or, when it did, it was of a limited scope. Thus, PPI was signed without protecting consumer interests. In August 2010, FSA published „The assessment and redress of Payment Protection Insurance complaints“ in which it expresses serious concerns about widespread weaknesses in previous PPI selling

practices underlining their continuing role in taking further measures to achieve consumer protection (FSA Policy Statement 10/12, 2010, p. 3). UK evidence shows that there was a problem of mis-selling PPI, fuelled by generous commissions for salespersons selling PPI with credit (Garcia Porras; Van Boom, 2012, p.53). Widespread weaknesses in previous PPI selling practices were examined in case *British Bankers Association (BBA) v FSA*, which concerns part of the regulatory response to the mis-selling of PPI policies. In case *BBA v FSA*, on April 20, 2011 Royal Court of Justice (UK High Court) decided against BBA (Royal Courts of Justice, 2011) According to the judgment, the banks were ordered to design and sell products that are compliant with general principles of ethical behavior (McConnell; Blacker, 2012, p.103). UK High Court ordered banks to pay back up to £4.5bn in compensation to consumers over the mis-selling of PPI. On May 2011, BBA decided not to appeal against UK High Court ruling.

### **3. CONSUMER PROTECTION ISSUES ON PPI PRACTICES ACCORDING TO DIRECTIVE 93/13/EEC**

The underlying principle on which contractual relationships must be based is the principle of integrity and honesty, i.e. the principle of good faith. It is particularly emphasized in the insurance contract, which implies openness, honesty and reliability in the relationship between the parties at the time of the conclusion of the insurance contract and after the conclusion, until its fulfilment (Gorenc, 2014, p. 1449). The principle of good faith is a general clause, not a legal rule with the content and characteristics described, under which a concrete factual situation could be classified (Pavlović, 2014, p.579). Although a “duty of the utmost good faith” applies in insurance contract as between insurer and insured, the duty mostly applies to protect the insurer and it is not considered to provide adequate protection for the insured, particularly in consumer transaction (Smethurst; Heukamp; Goodliffe, Miller, 2012). Conduct of business regulation: a survey of the UK regime and a comparison with US, German and Hong Kong approach, in: *Research Handbook on International Insurance Regulation*, Edward Elgar Publishing, UK-USA, p. 366). Same rights for consumers in EU (harmonization) and high level of consumer protection are the goals of Directive 2011/83/EC on consumer rights. But, pursuant to Art. 2(1) and Art. 3(3) Directive 2011/83/EC, its provisions do not apply to contracts for financial services (service of a banking, credit, insurance, personal pension, investment or payment nature). Although to these contracts for financial services apply the provisions of Directive 2008/48/EC on credit agreements for consumers (Consumer Credit Directive) its provisions do not regulate contract law issues related to the validity of credit agreements (Preamble 30 Directive 2008/48/EC). Nevertheless, according to Art. 10(2) Directive 2008/48/EC, the credit agreement shall specify in a clear and concise manner also and the sureties and insurance required. Before signing any credit contract, customers must have key information on the credit contract so credit provider must give them a standard document on pre-contract information – “Standard European Consumer Credit Information” (SECCI) in which the main terms and conditions of credit contract are prescribed, and also a note on important legal aspects. According to SECCI form credit provider must, among others, include the following information: is it compulsory (in order to obtain the credit or to obtain it on the terms and conditions marketed) to take out an insurance policy securing the credit or another ancillary service contract (Annex II, Directive 2008/48/EC). Insurance contracts as contracts between a consumer and a seller are consumer contracts and to them apply the provisions of Directive 93/13/EEC on unfair terms in consumer contracts. In other words, protecting consumers from unfair terms which might be included in contracts is guaranteed under Directive 93/13/EEC whose purpose is to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in contracts concluded between a seller or supplier and a consumer (Art. 1 (1) Directive 93/13/EEC). Directive 93/13/EEC introduces

the notion of ‘good faith’ to avoid any significant imbalance in mutual rights and obligations (Protecting consumers from unfair terms in contracts, 2015, p.1). According to Art. 3 (1) Directive 93/13/EEC, contractual term which has not been individually negotiated (drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract – Art. 3 (2) Directive 93/13/EEC) shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer. As a stronger contracting party the draftsman often, contrary to the principle of good faith, imposes on a weaker contractor, within the general conditions of the contract, provisions which put the latter at a disadvantage and affect him adversely either limiting or depriving him of certain rights or imposing excessive obligations on him (Mišćenić, 2013, p.114). In relation to unfair contractual clauses most commonly found in standard and adhesion agreements, in this case in the credit agreement, the content of the agreement is determined by the stronger contractual party while the consumer, as a weaker contractual party, is less protected. Consumers who may be ignorant to understand complicated financial contracts can become particularly vulnerable to mis-selling by distributors incentivised by remuneration structures to push financial products, irrespective of product suitability for the customer (Swanepoel; Esterhuysen; Van Vuren; Lotriet, 2016, p.33).

### **3.1. Unfair terms under Directive 93/13/EEC in Case C-96/14**

Terms must not only be formally understood, but their consequences should also be understandable by the average consumer (Howells; Straetmans, 2017, p.187). EU provisions on unfair terms in consumer contracts apply also to insurance policies. Directive 93/13/EEC on unfair terms in consumer contracts requires that the contractual term which has not been individually negotiated be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under contract, to the detriment of the consumer. This is undoubtedly a provision that can be applied to the underwriting of PPI policy as an integral part of the credit contract. According to Art. 4 (1) Directive 93/13/EEC, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent. The assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language (Art. 4(2) of Directive 93/13/EEC). The interpretation of EU law and the provisions of Directive 93/13/EEC fall within the jurisdiction of the European Court of Justice (ECJ). However, ECJ does not decide on invalidity of the contested contractual terms which is the jurisdiction of national courts of Member States in judicial proceedings in which a party invokes the unfair contractual terms. The Court decides by assessing the circumstances of each particular case. An important decision regarding unfair terms in consumer contracts refers to Case Jean-Claude Van Hove v CNP Assurances SA [2015] ECJ (Case Van Hove or Case C-96/14) in which a French Court referred a question to ECJ on whether a term in a loan contract, which was combined with an insurance contract, constitutes an unfair term under Directive 93/13/EEC, e.g. whether Art. 4(2) of Directive 93/13/EEC must be interpreted as meaning that a term of an insurance contract intended to ensure that loan repayments payable to the lender will be covered in the event of the borrower’s total incapacity for work, will, if that term prevents the insured person from receiving that cover in the event that he is declared fit to carry on an activity, paid or otherwise, fall within the exception set out in that provision (Preambula pod 29).

On April 23, 2015 Third Chamber of the ECJ pronounced a Judgment in Case C-96/14 relating to interpretation of Art. 4(2) Directive 93/13/EEC on unfair contract terms. It was decided that Art. 4(2) Directive 93/13/EEC must be interpreted as meaning that a term of an insurance contract intended to ensure that loan repayments payable to the lender will be covered in the event of the borrower's total incapacity for work falls within the exception set out in that provision only where the referring court finds: 1.) that, having regard to the nature, general scheme and the stipulations of the contractual framework of which it forms part, and to its legal and factual context, that term lays down an essential component of that contractual framework, and, as such, characterises it, and; 2.) that term is drafted in plain, intelligible language, that is to say that it is not only grammatically intelligible to the consumer, but also that the contract sets out transparently the specific functioning of the arrangements to which the relevant term refers and the relationship between those arrangements and the arrangements laid down in respect of other contractual terms, so that that consumer is in a position to evaluate, on the basis of precise, intelligible criteria, the economic consequences for him which derive from it. ECJ ruled that when concluding related contracts, consumer cannot be required to have the same vigilance regarding the extent of the risks covered by that insurance contract as he would if he had concluded the insurance contract and the loan contracts separately (Court of Justice of the European Union, 2015, p.2). The sentiments expressed by the ECJ are especially relevant with regards to the drafting of contracts, particularly insurance contracts, where legal notions are not easily comprehended by the average policyholder (Church, 2016, p.367). The European Court's ruling may lead to further challenges by consumers claiming that their insurance contracts are not sufficiently intelligible, are unfair and, therefore, void (Reinsurance Update, 2015, p.1) So, Judgment in Case C-96/14 clarified that Art. 4(2) Directive 93/13/EEC must be interpreted to determine whether the clauses that predict the limits and/or cases of exclusion regarding the effectiveness of an insurance agreement covering payment obligations of mortgage loan instalments in the event of a borrower's total incapacity for work fall within the concept of unfair terms (Marino, 2015, p.1). Consequently, contract terms require not only to be grammatically intelligible but also that the contract sets out the specific contractual mechanisms transparently in order that the consumer is in a position to evaluate the economic consequences which ensue from the contract (Van Boom; Desmet; Van Dam, 2016, p.188).

#### 4. CONCLUSION

Due to financial difficulties that for borrowers may arise during the contractual relationship and can be manifested by the more difficult fulfilment of contractual obligations, banks and other financial institutions have often inserted in the credit contract a contractual clause on PPI that became a standard financial product served with consumer credit. PPI is to cover liquidity, solvency, i.e. the possibility of settling all borrower's debts (debtor). In fact, this was an insurance that covered the risk of non-recovery of claims, i.e. non-payment to credit providers. In selling PPI, banks and other financial institutions did not exercise due diligence (commercial agreements must allow for due diligence of a prudent businessman) and evaluate the suitability of that financial product – to the client's needs (borrower, consumer). Selling financial (insurance) product that customers do not need, together with credit contract, represents situation of financial mis-selling which was highly profitable for banks and financial institutions for a long time. For borrowers (consumers), a weaker contract party) PPI did not have a positive effect in all cases since it is a product that was added to credit contract without consumers' knowledge and PPI policy in consumer credit in many cases ended before credit contract was finished. Equality of parties in market (obligatory, contractual) relationships is emphasized by the general principle of mandatory law - the principle of integrity and honesty or the principle of good faith. Sales practices of credit providers in UK consisted of unethical sales tactics and unfair sales practices of PPI.

By using such sales practices credit providers have misused the principle of good faith in contractual relationships and have betrayed the trust of consumers in their legal advice, professionalism, the insurance system and the overall financial system of the EU. For this reason, the UK Royal Courts of Justice judgment from 2011 is very important, by which it was ordered to a large number of English banks and financial institutions to pay damages to persons harmed (borrowers, i.e. consumers) due to PPI financial mis-selling, and the credit providers were ordered to behave in accordance with the general ethical principles when selling financial products. In order to ensure effective consumer protection across all financial sectors, including the sector of consumer credit and PPI, the authors point to the provisions from European sources on protection of consumer rights of borrowers, contained in Directive 2011/83/EC on consumer rights and Consumer Credit Directive. The authors have analysed the content of the SECCI form (set out in Annex II of the Consumer Credit Directive) which provides that credit providers give pre-contract information about the fact whether or not it is compulsory to take insurance policy for securing the credit. Since the legal basis of European consumer protection is founded on provisions of Directive 93/13/EEC on unfair terms in consumer contracts and provisions according to which a contractual term that has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under contract, to the detriment of the consumer. Undoubtedly, this provision can be applied to underwriting of PPI policy as an integral part of most credit contracts especially because it is a contractual term that was not individually negotiated and the level of informedness of the average consumer (borrower) unquestionably led to the conclusion of the contract whose contractual terms and conditions were drawn up solely by the credit providers, not adapting them to the needs of consumers. Concerning the assessment of unfairness of contractual terms in an insurance contract which was part of the loan contract, the authors have analysed the most recent judgment of ECJ in Case C-96/14 according to which it is very important to ascertain whether an average consumer could estimate the potentially considerable economic consequences for him that might arise from the signing of the contract, that is, it is emphasized that it cannot be expected from the consumer, who by signing the loan contract is also signing the insurance contract, to have the same vigilance as if he had concluded that contract and loan contract separately. With respect to the provisions of Art. 5 Directive 93/13/EEC according to which in case the wording of a contractual term is not clear – the interpretation most favourable to the consumer shall prevail, the authors conclude that the above explanations will be of utmost importance for assessing whether the contractual clause on PPI (contained in the credit contract) may be considered unfair.

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## SUBJECT MATTER AND CONTENT OF COURT SETTLEMENT

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### **ABSTRACT**

*A court settlement is an agreement whereby the parties regulate their civil law relations which they may freely dispose of, concluded in written form before the competent court in civil or non-contentious proceedings. This contract has the capacity of a final judgment, and if the settlement mandates a compulsory feascance, then it has the capacity of an enforceable instrument. As one of the ways of resolving disputes, it has found a very successful application in the practice of solving European countries. In these countries, formal assumptions have been created for the full application of legal provisions on judicial settlement as a peaceful way of resolving the dispute. The paper examines the legal sources of the subject matter and content of the court settlement in Croatian law as compared to the legal systems in some member states of the European Union. The focus is on the question whether the court settlement can be concluded on issues that are not the subject of a dispute in a particular litigation, but are related, or even not related with it. It points to the attitude of the legal theory of European countries that the content of the court settlement may not be related only to the legal claim for which protection has been initiated, in order to cover all legal relations of the parties and to resolve the disputed situation. Proposals are made to improve de lege ferenda in order to create legal prerequisites for the successful resolution of disputes by the court settlement in Croatian law.*

**Keywords:** *content of court settlement, court settlement, subject matter of court settlement*

### **1. INTRODUCTION**

Court settlement is an alternative way of dispute resolution with respect to the regular dispute resolution by a substantive court decision – judgement. It showcases the parties` autonomy in conformity with the principle of party disposition in the civil procedure. Court settlement is regulated by the provisions of Chapter 22 of the Civil Procedure Act (CPA). Throughout the entire civil procedure, the parties may conclude a settlement on the disputed subject matter (litigation settlement). The court shall inform the parties about the possibility of negotiating a settlement and help them conclude it. The settlement may refer to the entire claim or only a part thereof. The settlement regarding the claim the parties may not freely dispose of cannot be concluded before the court. When the court issues a decision disallowing the parties` settlement, the proceeding shall be suspended until the decision becomes final. The parties` agreement on the settlement shall be entered in the record. The settlement is deemed concluded after the parties have signed the settlement record upon reading it. The court shall issue the certified record transcript containing the settlement upon the parties` request. During the entire procedure, the court shall *ex officio* monitor whether the procedure concerns a case with a previously concluded court settlement; it shall dismiss the claim if it establishes that the proceeding indeed concerns a case with a previously concluded court settlement. The tentative claimant may attempt to reach a settlement through the competent court of first instance where the opposing party has a registered domicile. The court with which such motion was filed shall summon the opposing party and introduce them with the settlement motion (pre-litigation settlement). The moving party shall settle the costs of such proceeding (Articles 321-324 of CPA). Court settlement may be concluded by the parties in the civil procedure, but not by interveners. Intervenors may join the settlement concluded between the parties in the civil procedure.

If the settlement is concluded between one of the parties and a third person, it does not immediately imply the termination of the proceeding.

## **2. NOTION OF COURT SETTLEMENT**

CPA does not define the court settlement. Hence, the definition is provided by the legal theory. Court settlement (*res iudicialiter transacta*) is an agreement whereby the parties regulate their civil law relations which they may freely dispose of, concluded in written form before the competent court in civil or non-contentious proceedings. This contract has the capacity of a final judgment, and if the settlement mandates a compulsory feasant, then it has the capacity of an enforceable instrument (Triva, Dika, 2004, p. 570.). The notion that the court settlement allows the parties to regulate their civil law relations, which they may freely dispose of, considerably limits the subject and content thereof. Such notion limits the possibility to conclude a court settlement on a non-civil subject matter, e.g. in some of the procedural cases or deriving therefrom. Thus, it is prevented that the court settlement contains the provisions concerning the existence of a litigation and its outcome (Dika, 2013, p. 515-516). Therefore, the court settlement should be defined as an agreement concluded between all parties or one party and/or, possibly, a third person, based on the implicit court approval during civil or non-contentious proceedings by signing the court records. With this agreement, the signatories entirely or partially regulate their relations concerning the subject matter and/or deriving therefrom. Said agreement may have (some) effects of the final judgement. If such an agreement mandates a compulsory feasant, it can also have the capacity of an enforceable instrument (Dika, 2013, p. 515). The more recent legal theory has a similar standpoint. It defines the court settlement as an agreement concluded and recorded in a proceeding before the court. With this agreement, the parties entirely or partially regulate their contentious relations which are indirectly subject to the dispute. In terms of its effect, the court settlement has the capacity of a substantive final judgement – *res iudicialiter transacta* (Pravni leksikon, 2007, p. 1553).

## **3. COURT SETTLEMENT SUBJECT MATTER**

Court settlement is concluded on the disputed subject matter, i.e. the claim (Article 321 paras 2 and 4 of CPA). Hence, the definition of the court settlement subject matter depends on the previous definition of the notion of the disputed subject matter and the claim. Statutory regulations which define possible court settlement subject matters originate from the last quarter of the 19<sup>th</sup> century when the notion of claim was used for a civil law claim. It was believed then that there are only condemnatory and declaratory claims. The revelation that there are constitutive claims as well resulted in the fact that the notion of claim started to include the sought relief which affected the increase in the number of theories defining the disputed subject matter (Dika, 2013, p. 549). The subject matter of the litigation and pre-litigation settlement or non-contentious settlement should not considerably differ, because all settlements have the capacity of a court settlement and the same legal effects. Pre-litigation court settlement is concluded before stating the claim. Therefore, the subject matter of the pre-litigation settlement may refer to the contentious relationship between the parties and the rights deriving therefrom. The claim cannot be the subject matter of the pre-litigation settlement as it has not been stated. In view of the above, the subject matter of a litigation and pre-litigation or non-contentious settlement should refer to: a) civil law relations or rights on the grounds of which legal protection may be sought, because they are an indirect disputed subject matter in a civil proceeding, and b) whatever has been requested by a claim concerning said relations or could be sought in a pre-litigation settlement. Hence, the subject matter of a litigation settlement may be considerably broader or different from the subject matter of the concluding civil proceeding. Thus, in addition to the matters included in the claim, this may also resolve the legal destiny of the matter yet to be stated in the procedure of claim reversal or by filing a counter-claim or a

plea for offset. It can also resolve the issue of existence of preliminary legal relations or the rights subject to special declaratory claims (Dika, 2013, p. 550). Said arguments are adopted in the case law as well. The judgement of the Supreme Court of the Republic of Croatia Rev-2351/92 of 19 November 1992 stated that the fact that the parties' agreement was concluded as a court is significant only for the procedural effects of the agreement. Considering said features of the court settlement, the parties would often be unable to reach the settlement if their settlement stipulation were limited to the disputed legal relation. On the contrary, the parties will, same as if they were settling out of court, sometimes include in the settlement also the legal relations which are not subject to the civil procedure, but which may nevertheless contribute to the resolution of disputes and mutual misunderstandings (Grbin, 2007, p. 296). Litigation court settlement should be concluded on the issues which are not an indirect disputed subject matter in a specific civil proceeding, but are potentially connected therewith (related settlement) or unrelated with the indirect disputed subject matter (unrelated incidental settlement). The legal theory does not have a uniform standpoint on whether a court settlement could be concluded on the issues unrelated to the indirect disputed subject matter. According to the opposing viewpoints, the litigation court settlement usually refers to the disputed subject matter. Only the settlement of that kind may result in the termination of the civil proceeding. It is not implied that a settlement could not be reached in a civil proceeding on a relationship which does not refer to the indirect disputed subject matter, but is nevertheless related therewith (Triva, Dika, 2004, p. 572). Court settlement may only partially resolve the subject matter in a specific civil proceeding. In that sense, it corresponds to a partial decision in terms of its capacity and content. In civil proceedings with a dispute in terms of grounds and amount, the court settlement may resolve only the issue of grounds of the claim. Such settlement would correspond to an interim judgement in terms of its capacity and content (Stokić, p. 5). Court settlement subject matter should not include legal relations, rights and pertaining claims which the parties cannot dispose of – Article 321 para. 4 of CPA (e.g. in marital disputes).

#### **4. COURT SETTLEMENT CONTENT**

The settlement may, directly or indirectly, resolve the disputed relation in different ways:

- in the form of a civil law agreement
- the settlement could, besides the provisions of the civil law agreement, contain the declarations in the capacity of procedural actions based on which the established procedural law relation would be resolved differently,
- the settlement could resolve certain factual issues,
- the settlement could contain the consent for subjective and objective claim reversal, counter-claim or plea for offset, which may resolve the destiny of thus reversed claim, filed counter-claim or stated plea for offset,
- the settlement could contain the declarations which may showcase their procedural law effects out of court.

In terms of content, there could be three types of settlement: a) substantive law settlement, b) procedural law settlement, and c) combined settlement (Dika, 2013, p. 554).

#### **5. GERMAN LAW**

German law in volume 8 of the Civil Procedure Act (Zivilprozessordnung; dZPO) under “Enforcements” (Zwangsvollstreckung) contains a single provision on the court settlement titled “Other enforcement titles” (Weitere Vollstreckungstitel) § 794 para. 1. Said provision defines that the enforcement may be established:

- based on a settlement concluded between the parties or one of the parties and a third person for the termination of the dispute entirely or partially

- based on a settlement concluded on the grounds of § 118 para 3 – settlement concerning the assistance in the compensation of procedural costs
- based on a settlement concluded on the grounds of § 492 para 1 – summoning of the parties to an oral deposition in the procedure of gathering evidence aimed at the conclusion of the settlement, whereby the reached settlement should be recorded in writing.

German law is not familiar with the pre-litigation settlement (Dika, 2013, p. 518).

## 6. AUSTRIAN LAW

Austrian law in chapter 9 of the Civil Procedure Act (Zivilprozessordnung; öZPO) titled “Procedural measures” (Die Prozesshandlungen), subtitle “Legal comparisons” (Der gerichtliche Vergleich) contains a provision on the court settlement whereby the court may, during hearing, upon the proposal or ex officio attempt to amicably resolve (Beilegung) the dispute or reach (Herbeiführung) a settlement on certain disputed issues (§ 204 para. 1 of öZPO). If the settlement is reached, its content should be entered in the court record upon proposal (§ 204 para. 2 of öZPO). “Procedure before the county courts” (Das Verfahren vor den Bezirksgerichten) in provision § 433 of öZPO prescribes the obligation to file a motion for a pre-litigation action. Unlike CPA which prescribes the possibility to file a motion for a pre-litigation settlement, öZPO prescribes the obligation to file a motion for a pre-litigation settlement (§ 433 of öZPO). öZPO does not provide a definition of the court settlement. Therefore, the legal theory provides neutral definitions of a court settlement which are not based on the legal effects thereof. Court settlement (litigation or pre-litigation) refers to an agreement which has been reached and recorded before the court on contentious claims or legal relations for partial or complete termination or prevention of a civil proceeding. Another definition states that a court settlement is an agreement reached and recorded before the court whereby the parties, nominally, terminate the ongoing civil proceeding or regulate certain items of dispute. Said definition is based on the provision § 204 para. 1 of öZPO. That definition is even more neutral and vague in terms of a possible subject matter of the settlement and the effects thereof (Dika, 2013, p. 518). According to the standpoint of the legal theory, the court settlement subject matter may, basically, be anything which may be subject to a judgement. However, the settlement subject matter should not include the legal relations, rights and the pertaining claims on which the substantive or procedural law disallows the conclusion of a settlement in the public interest. Thus, for instance, the settlement cannot be concluded on the claims deriving from unauthorised or illicit transactions, validity of matrimony, content of a will, etc. (Rechberger/Simotta, 2010, p. 345, Rz-630).

## 7. CONCLUSION

It derives from the performed comparative analysis that the legal systems of Germany and Austria have substantially reduced the legal norms defining the institution of a court settlement. Thus, they enabled the legal theory to have extensive freedom in the establishment of said institution by filling the legal gaps. The legal regulation of the court settlement in Croatian law is considerably more elaborated than in German or Austrian law. In spite of that, there is a whole range of practical ambiguities in terms of the court settlement subject matter and content. The main stumbling block is detected in Article 321 paras 1 and 2 of CPA which prescribes that the settlement may be concluded on the disputed subject matter, and that the settlement may refer to the entire claim or only a part thereof. It derives from the grammatical interpretation of said statement that the court settlement may be concluded only in terms of the stated claim or a part thereof. However, such interpretation is contrary to the aim and intended purpose of the institution of a court settlement. Therefore, the case law interprets said provision teleologically, i.e. in conformity with the aim and intended purpose of the institution of a court

settlement as an alternative method of dispute resolution. The case law emphasises the need to sometimes include in the court settlement also the legal relations which are not subject to a dispute, but which may contribute to the resolution thereof. This comprehensively solves the issue of all contentious relations between the parties. Such approach to the subject matter and the content of a settlement has a motivating effect on the parties to resolve the disputes amicably – by way of a court settlement. Hence, the case law emphasises that the provision of Article 321 paras 1 and 2 of CPA which prescribes that the court settlement may decide on the disputed subject matter or a claim results from the procedural law effects thereof. However, said provision should not be interpreted as if the settlement may encompass only the items stated in the claim. In support thereof, the legal theory indicates that the notions of the claim and the disputed subject matter are not synonymous. The case law and the legal theory agree in their standpoints that the court settlement may be concluded in terms of the disputed subject matter and the indirect disputed subject matters. However, they do not agree on whether the court settlement subject matter may include the issues unrelated to the indirect disputed subject matter. We believe that the court settlement should be used to decide on the disputed subject matter, but also on the issues unrelated to the indirect disputed subject matter. It would, thus, encompass all legal relations of the parties and resolve contentious situations which would contribute to a more frequent resolution of disputes by way of a court settlement. We believe that said standpoint conforms to the existing regulation of the institution of a court settlement. In fact, the conclusion of the court settlement on the issues unrelated to the indirect disputed subject matter may be considered a claim reversal and consent to a claim reversal or resolution of a counter-claim and the plea for offset. In order to avoid any ambiguity as to the subject matter and the content of a court settlement, we believe that the Croatian law should model the institution of a court settlement after German and Austrian law. The minimalistic legal regulation of said institution would enable the case law and the legal theory to fill the legal gaps and thus establish the institution by creating the formal requirements for the application thereof as an amicable method of dispute resolution. In conformity with the minimalistic Austrian and German legal framework of this legal institution, we believe that the provision of Article 321 paras 1 and 2 of CPA should be deleted. This would remove the main stumbling block for the application of the institution of a court settlement as an amicable way to resolve disputes. Deletion of the provision which grammatically limits the conclusion of a court settlement to the content of the stated claim would enable the teleological interpretation of the subject matter and the content of a court settlement. Thus, in conformity with the Austrian doctrine, we would be able to assume that the subject matter of a court settlement may, basically, be any matter subject to a judgement. Such standpoint implies that the court settlement may be concluded on the disputed subject matter, issues related to the indirect disputed subject matter, but also the issues unrelated to the indirect disputed subject matter. This would enable the establishment of the legal requirements for a successful and amicable resolution of disputes *de lege ferenda* in Croatian law – by way of a court settlement. Said statutory regulation would realise three main advantages of a court settlement: 1) the court settlement represents a more flexible instrument for the regulation of legal relations between the parties than the judgement, 2) by its content, the court settlement is not related only to the claim protected by the civil proceeding, hence it may encompass all legal relations of the parties and remove all contentious situations, and 3) as an act of the will of parties, the settlement represents the consensual establishment of rights and obligations deriving from the mutual legal relations.

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## DOES IFRS ADOPTION AFFECT THE QUALITY OF FINANCIAL REPORTING IN RUSSIA? - THE HISTORICAL ASPECT

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### ABSTRACT

*The key idea of the paper is to compare the financial reporting quality before and after International Financial Reporting Standards (IFRS) adoption in Russia. Firstly, the paper suggests a retrospective analysis of accounting standards development in Russia. Secondly, the main problems of IFRS implementation in Russia are being discussed. The main aim of the paper is to show how the transition to IFRS process in Russia run and suggest methods to improve it. The paper contributes to the question if the convergence of Russian Accounting Standards (RAS) with IFRS affected the financial reporting quality of listed firms in Russia and what was the historical influence on the quality of reporting. Since the paper is devoted to the transition of the accounting system in Russia to IFRS, it looks at the history, approaches and teaching of IFRS in Russian Federation in order to provide a broader international perspective of this important arena that shapes the view of accounters. Besides, the paper illuminates the most of the problems, connected with the transition process in Russia. It is done by describing the overall context of accounting education and experience in implementing of IFRS within the contemporary Russian accounting system and the system of higher education. These findings are consistent with the hypothesis that the globalization causes the growing interdependence of the countries around the world and paper contributes to solving the existing problems caused by transition and suggesting ways to improve this process.*

**Keywords:** *Accounting Education, Accounting History, Financial Reporting, Harmonization IFRS*

### 1. INTRODUCTION

The historical approach becomes increasingly demanded in various fields of knowledge now. Undoubtedly, study of accounting evolution is possible only in the process of researching the experience and knowledge accumulated over the centuries of accounting theory and practice development. Recent achievements in software and information technologies allowed escaping from mainly empirical development of an accounting science to the development of its uniform concept on the basis of global mathematical model. Commonly, in accounting history it is used to allocate two basic periods - underliterary and literary. The first period is characterized by the absence of textbooks, the second - by their presence. However, the accounting science experiences an objective need for studying a new stage of its development, which is characterized by arising and developing the fundamentally new model of accounting, a mathematical one. The accounting history begins with the papyrus in ancient Egypt; so-called, the accounting on scrolls; the daily calculation of the rests; inventories; accounting on the cards - clay tablets in Babylonia; the appearance of the accounting legislation in the form of Hammurabi laws. Almost everything of this became an integral part of current financial life in one or another form. Development of an accounting as a science was promoted basically by trade relations. We can't ignore yet one of the most important preconditions of the accounting development – a Great Migration of Peoples.

And the enormous role played by the Sarmatians, and in particular, the Alans, in the conquest of Europe. Absorbing cultures of overthrew people; the Alans spread its symbiosis throughout the Western Europe. As for the literary period, none of its descriptions is complete without mentioning of Luca Pacioli's paper "Summa de Arithmetica, Geometria, Proportioni et Proportionalita" ("Everything About Arithmetic, Geometry and Proportion") and one of its 36 chapters "De Computis et Scripturis" ("About Accounts and Records") that contains a detailed description of the Venetian version of the double-entry accounting, but there is no information about the history of its creation. Nevertheless, the earliest systematized work in accounting history was presented by Benedetto Cotrugli "About Trade and Perfect Merchant" (1458). Though the work is dated by August, 25 1458, it was printed in Venice in 1573. In Luca Pacioli's days, accounting was considered as a tool necessary for economic an activity which brings the income. The issues of accounting performance have been discussed since the moment when accounting had positioned itself as a branch of economic science (since the XIX century in Europe and since the end of XIX century in Russia). Since 1495 Russian accounting books (first reports) appear to exist. Though, the compiling process differed from one to another their preliminary aim consisted sole in payments to the state and other income taxes. For a long time Russian accounting developed primarily under the European influence. Main changes occurred due to Peter the Ist reforms. During his reign in the staffing dated 1710 appeared the word "accountant" that displaced the earlier Russian version "counter". Later in 1722 the "Table of Ranks" that contained the position an "Accountant for Collegiate" was issued. The first printed accounting book appeared in Russia in 1783, named "The Key for the Commerce and Trade, i.e. accounting science..." Thus, state government remained the main user and aim of the accounting reporting. The complete absence of social aims and excluding the internal user's purposes in accounting reporting caused different inaccuracies and distortions. This directly affected the quality of accounting reporting. Since Russian economy has undergone severe changes and turned from planned to market type, the accounting reporting changed as well. In this regard the main fact that influenced the quality of accounting reporting is the transition from National Accounting Standards to IFRS in 2001. The most important expectations of the transition to IFRS process differ from one user of accounting information to another. Thus, from the side of stakeholders, the introduction of IFRS is expected to bring important benefits that among all will out-weight the short term costs. The benefits of comparable financial reporting are significant for the companies that need investing from external investors. As to investors, it is important that financial statements are understandable and reliable. For management, this will make the company activities more transparent. For policy-makers, it could help strengthen Russia's capital market and regulators could benefit from improved regulatory oversight and enforcement. More broadly, other stakeholders would benefit from overall improved transparency of company accounts. As it occurs in the world economy practice international standards influence local accounting mostly by two ways: by insertion of its parts into legislative requirements and local standards as well as by direct using of IFRS in financial reporting by significant amount of Russian enterprises, e.g. credit organizations, which are required to do so by the Bank of Russia. On the background of globalization processes in economics, creation of trans-continental companies and international stock markets, Russian accounting needs new methods to meet the requirements of the global economic community. New international technologies changed the market environment (e.g. Whittington, 2005) and the expectations of users of financial statements. With the elimination of territorial barriers, that were stumbling blocks for many countries, information became available to the business community in any part of the world. This brought to the capital markets huge amount of new investors. Russia tries to participate in the international accounting processes actively, as in such circumstances neither men nor organizations can withdraw into their national framework.

The importance of the Russian accounting system convergence to IFRS is also emphasized by the need to enable users of financial statements from different countries "speak the same language". This paper also looks at the effects of globalization process in developing countries in order to provide accounting specialists outside them a broader international perspective of this important arena that influences on the possibilities of the transition to the new level of interaction. The paper suggests the description of the overall context of globalization within the contemporary accounting systems in developing countries and describing and evaluating the methods and instruments that are used in order to integrate the different accounting systems on the uniform basis. Since the globalization affects all economic and business processes, regardless of where the company operates, the problem of globalization is central to the social, political and cultural life, being one of the most controversial. The questions whether globalization is a unidirectional process or suggests alternative ways of development remain opened for a decade. Following the latest research works (i.e. Larsson T., 2001, Margelov, 2003, Giddens, 1991, etc.), there are many definitions of globalization, even conflicting with each other. However, a comparative analysis of different points of view helps to assess the process of globalization adequately. The effect of globalization on social and other components of our lives can be easily traced and in common case it is always understood as a kind of uniting process. From the economic point of view, the essence of globalization of the world economy lies in the formation of a special type of a new global financial system, the emergence of global companies, the intensification of world trade, etc. Geographers examine the problems of large cities - cities, the so-called "economic archipelagos", emerge due to the globalization of the world economic space, and consider the phenomenon of globalization through this prism. Sociologists explore issues related to the influence of the universalization of the culture, its hybridization or the way people live in different countries and regions. Philosophers are also actively involved in the discussion of the phenomenon of globalization. Held D. et al (1999) note that although the globalization refers to the widening, deepening and speeding up of global interconnection, it can be located on a continuum with the local, national and regional. From such point of view the effect of globalization in developing countries in social and economic relations and networks can be represented as follows (Table 1):

*Table 1. Impact of globalization on the developing countries.*

<b>Levels/relations:</b>	<b>Social</b>		<b>Economic</b>		<b>Networks</b>	
<b>Local</b>	Intensity	Low (L)	Intensity	H	Intensity	M
	Speed	L	Speed	H	Speed	M
<b>Regional</b>	Intensity	Medium (M)	Intensity	M	Intensity	H
	Speed	M	Speed	M	Speed	H
<b>National</b>	Intensity	High (H)	Intensity	H	Intensity	H
	Speed	H	Speed	H	Speed	H

As it is represented above, globalization effects much more intensively and quick on national level, but the one aspect that is affected mostly, regardless of considered levels, is Economic one. At the same time the success of each enterprise in modern conditions are increasingly dependent on their knowledge and ability of effective use of the information about their internal resources and external environment (Sidorova M., 2013). In the world-system, where a new type of society is forming, the information plays a crucial role. Development of rational decision-making at various levels of management requires processing large amounts of data, complex procedures for their analysis and interpretation. This fact seems to be a stumbling block on the way of harmonizing of national accounting systems as it complicates their

conceivability due to the difficulty of their observation and the visible variety of accounting techniques. From this statement it follows that it is necessary to move in the direction of creating accounting meta-models which are compact and universe and which are invariant to the initial accounting data but easily adaptable to the existing national accounting systems in all their diversity. One of the effective tools of creating such meta-models as prior research shows (e.g. Demski J. and FitzGerald S., 2008; Stoner and Vysotskaya, 2012) is mathematic modeling, in particular the one which uses the basic notions and operations of matrix algebra and can be helpful to implement IFRS completely in developing countries (Technology Forecast, 2012). At the same time there is a part of conservatism and stereotypes of accountants in developing countries due to their age, social influence and experience in the national systems of accounting.

## **2. LITERATURE REVIEW**

The majority of the literature relating to the research problem falls in to two broad areas. Firstly, the paper provides a literature review of globalization process, status and trends. Secondly, it is necessary to view the literature which prescribes the need for accounting in developing countries to change in response to the increasing internationalization and marketization of its economy. Considering the worldwide phenomenon of globalization, one should note the multidimensional and universal nature of this phenomenon that is inherent in the very definition of it. In the works by Grant Mcburney (2001) the globalization process is viewed as a political paradigm of higher education, namely, he writes about the four dimensions of this phenomenon: economic, political, technological and socio-cultural. He also connects the emergence of the term with the economic component: for example, some researchers believe that the firstly the term "globalization" was used by an American scholar of German origin Theodore Levitt in (1983). Margelov (2003) gives an non-economic interpretation of the term and emphasizes strengthening of social ties in the general historical context of the world. Matsuura (2000) sees the technological dimension of globalization, focusing on the global spread of technology. Russian researcher Kuznetsov (1998) also draws attention to the “diversity” concept of globalization. Despite the fact that in the simplest sense, globalization - this extension, deepening and strengthening of social connections, such approach to the determination requires clarification. The problems of accounting development and IFRS implementing were discussed in works by following authors: Bagaeva, A. (2008), Enthoven, A.J.H. (1999), Krylova, T. (2003), McGee, R. and Preobragenskaya, G. (2004), Sarikas, R. H., Djatej, A. M. (2005), Valentinčič A. (2013). The implementation of International Financial Reporting Standards in Russia has been discussed by the accounting profession for more than a decade. The united opinion of professionals is that those standards must become an integral part of business life of enterprises and be included in statutory norms in Russia (Vysotskaya and Prokofieva, 2013). Richard Mattessich, Giuseppe Galassi (2000) indicated the main stages of matrix algebra application in economic research, accounting and information economics. Arthur Cayley is one of the founders of matrix algebra who in 1894 wrote the book on the system of double records in accounting. D. Rossi (1895) the chess form of accounting was created.

## **3. ANALYSIS OF THE GLOBALIZATION STATUS AND TRENDS IN DEVELOPING ECONOMIES**

Like any field of human activity, accounting in Russia was influenced by different circumstances. The primary role belongs to the European school of thought. The connection was established in the XVIII century by Peter the Great who undertook several financial and accounting reforms to introduce the cameralist method of accounting. The accounting reform was established to satisfy specific State's needs for improving public administration and was largely influenced by Swedish and Dutch accounting practices (Platonova, 2009). Considerable attention was given to developing accounting education, in particular, setting up special

accounting schools and training of first accountants. As part of the educational reform, people were sent abroad to learn about European accounting model and to bring books on accounting that were translated later into Russian. Thus, the creation of accounting regulatory framework was done simply by transferring western accounting practices. Development of accounting in Russia was guided by application in five business areas, including monasteries, manor houses, households, trade and usury, construction and industrial production. One of the vivid examples of application of a newly established accounting framework was Regulation “On management of Admiralty shipyards” dated April 5, 1722 and announced after the construction of a shipyard in St. Petersburg. This document provided a fairly rigorous system of cost accounting and influenced the entire accounting system by introducing one general rule: “it is not the reality, but primary documents that need to be accounted for” (Genin, 1937). Abolition of serfdom in 1861 and further industrialization of the country brought the need for further improvements in accounting. Development of state factories required much more detailed framework for cost accounting. One of the innovations of the XIX century was introduction of the “Journal”, a document that listed all business transactions in a chronological order. Another innovation was introduction of accounting for labor in the “List of craftsmen”, and accounting for raw materials in a special bookkeeping journal. In the end of the XIX – beginning of the XX centuries Pavel Reinboth promoted the concepts of direct and indirect costs, developed the annual absorption costing system and introduced “rate of costs” as one of the primary indicators of production efficiency (Vysotskaya, 2010). Developments in cost accounting brought about improvements in financial accounting. The double-entry method was widely spread, but was still based on the German model of accounting where all homogeneous transactions were accumulated in the General journal and finalized in the General Ledger in the end of the accounting period. Innovation of the time was wide promotion of the Italian model of accounting where each transaction had to be recorded in a journal separately and transferred to the general ledger separately as well. “Course in double-entry accounting” by Alexander Prokofiev that described this system, became the guideline for several generations of Russian accountants. However, despite advances in corporate development, the double-entry system was more established in cost accounting than in corporate accounting. In the meantime, a group of researchers tried to challenge the principles of the double entry system and introduce their own accounting systems. However, such innovative accounting systems did not withstand the time test (e.g. the triple-entry system introduced by Fedor Jezierski). Accounting development continued with establishment of “Schetovodstvo” (Accountancy) journal. Published between 1888 – 1904, the journal included papers of well-known in Europe accounting professionals, namely, Adolf Wolf, Alexander Beretti, Lev Gomberg and others. Accountancy profession at that time required intelligence, education and analytical thinking. Development of business sector created high demand for accounting professionals who were well rewarded for their services and were well respected in the society. Significant changes in the Russian economic environment took place with the collapse of the USSR. During the 90s, accounting reflected changes associated with a transition from a command control system to a market economy that resulted in a growing demand of professional accountants in fast-growing business areas. Besides, new forms of enterprises (e.g. cooperatives and joint Soviet-foreign enterprises) required new accounting rules. Harmonization with international accounting standards was able to partially resolve these issues, but did not solve the main problem of Russian accounting. The State remains the main user of financial information and the major application of corporate accounting is limited to tax reporting. During the 2000–2008 the re-birth of Russian accounting took place. It was caused by economic growth spur driven by private consumption and investment, dramatic increases in the world prices on energy and commodities (Berglof and Lehmann, 2009). In such circumstances, a question of harmonization with international accounting standards became of utter importance.

The Concept of Accounting was formed during the transition period from planned to market economy. Its main purpose was to change the main aim of accounting: in planned economy accounting aimed to provide information for the State, the new Concept of accounting was to create a market-based infrastructure that provides a favorable climate for private investment, including foreign investment. Since, in Russia, historically Continental system of regulation of accounting was used, the adoption of the Concept in 1997 has shifted the model of regulation of accounting and reporting to the Anglo-American one.

### **3.1. IFRS in developing countries. A case of Russia**

Among the most serious problems of IFRS implementation in Russia, it used to mention the next:

1. The lack of official status of financial statements prepared under IFRS, as well as the necessary infrastructure of IFRS;
2. The formal approach of regulators and businesses to many categories, principles and requirements of the accounting and reporting, comply with the conditions of market economy;
3. High costs of business entities to prepare consolidated financial statements according to IFRS through the transformation of financial statements prepared under RAS;
4. Significant administrative burden on businesses to report excessive reporting to state authorities, as well as unnecessary costs because of the need for parallel accounting to tax records;
5. Poor quality control system accounting, including the poor quality of the audit of financial statements;
6. Lack of involvement of professional associations and other interested public, including users of financial statements, management accounting and reporting;
7. The low level of training most of the accountants and auditors, as well as lack of skills in the use of information prepared under IFRS.

According to the recent trends in accounting education in Russia (Getman V., 2011), the above mentioned problems are not solved so far. In particular, there can be outlined following objectives:

- a) Conduct training on the reorientation of accounting in-depth study of IFRS;
- b) Monitoring of the quality of educational programs;
- c) Implementation of management training in this regard;
- d) Ensuring that the training of professional accountants;
- e) Certification of Professional Accountants, based on IFRS;
- f) Upgrade training and methodological support of education.

However, the reforms in the field of accounting seriously complicated the achievement of the goals. Since in 1995 the Institute of Professional Accountants and Auditors in Russia was established, the process of transition to IFRS began. The role of the Institute was to promote the development of accounting reforms and provide continuous professional development. Thus, due to the ongoing reform of education, were admitted the following steps:

1. Reduction of 1-year study period (from 5 years up to 4);
2. The rules set in the federal state educational standards are extremely out of place, since the drafting of this standard is carried out within the existing system of services under the state order.

Thus, there is a need of re-designing the accounting education as, among all, there is a certain lack of professional disciplines in the profile of accounting.

It should be noted that the whole world is now moving in the opposite direction, namely towards the harmonization of curricula, but according to Russian GEF, curriculum development is in the responsibility of each university. As a result, there is no reorientation of contemporary accounting education for in-depth study of IFRS. In addition, in the renewed list of specialties and areas of training of tertiary education in Russia the accounting as an independent field of training disappeared (Ministry of Education Decree, 2013). Since there is a definite dependence between even the size of the company and the number of employed accountants, one can judge how the demand on the specialists rose to the extent of the growing amount of enterprises (Table 2).

*Table 2. Dependence between the size of the company and the number of employed accountants*

Size of the enterprise	Total number of employees	The total number of accountants	The av. number of employees per accountant
Small	<20	1-3	7
Medium	20-200	5-10	20
Large	200-1000	10-20	50
Extra large	>10000	>100	-

Besides, almost all recruitment companies (i.e., Head Hunter, Job.ru) mention that there is a positive dynamics of labor market in accounting and finance sphere, the dimension between the most popular specialists is the following:

- Accountant - 26.7%
- Finance Manager - 19.3%
- Finance Director - 17.1%
- Chief Accountant - 12.5%
- Accountant of the sector - 9.7%
- Financial Controller - 7.9%
- Auditor - 6.8%

But one of the most serious problems in adopting IFRS in Russia lies in the sufficient lack of official Russian translations of IFRS in recent years, most accountants were using unofficial Russian translations of IFRS (Tyrall et al. 2007). There were attempts to develop a new accounting terminology in order to cover accounting concepts not needed during the Soviet era. As the common trend, the query of Romir Monitoring in 2006 showed that the representatives of professional accounting organizations give relatively high marks on usefulness of IFRS in the moment (48% of representatives of accounting organizations overall adoption of IFRS as the "most useful" and "very useful" for their clients ). About future possibilities and prospects of IFRS professional accountants were even more unanimous: 70% of respondents believe that the adoption of IFRS in the future will be "most useful" and "very useful ". Most representatives of the professional accounting organizations (46% ) noted that IAS is used less than in 25 % of organizations from their customers. 38% of professional accountants noted that their customers are not using IFRS (Romir Monitoring, 2006). Besides, from the same report, more than half (58%) of accountants in commercial organizations were satisfied with using of international standards in their organizations . Among the representatives of the accounting organizations such amount reaches 69% of respondents. A similar opinion was expressed by teachers and students, more than 70% of them believe that the adoption of IFRS by Russian organizations is currently "more useful" or "very useful."

### **3.2. Quality of reporting and problems of IFRS implementation**

There is a certain need to adjust the standards with the help of the experts in the field of accounting education. Among other things, the very weakness of the standard under consideration is the lack of professional disciplines in the profile of accounting. It should be noted that the whole world is now moving in the opposite direction, namely towards the harmonization of curricula, but according to Russian GEF, curriculum development is the responsibility of each university. The current, third generation of the standard makes a complete decentralization of the education system. There is no reorientation of contemporary accounting education for in-depth study of IFRS. For example, if a second-generation standard IAS discipline was fixed officially in the curriculum, the third generation of the GEF is absent, and the inclusion of this discipline in an educational program given into the hand of the university. In addition, the new standard could significantly hinder monitoring the quality of educational programs, as there are no standard educational programs. Within the integration of Russia into the world economy and the globalization of capital markets, such problems as lack of the comparability of financial statements and the inadequacy of financial information to accurately assess the risks for making decisions by investors compounded. Development of the company in modern conveniences depends on many factors, among them is the quality of the information contained in the financial statements. Improvement of the quality remains the key point of accounting reforms in Russia recent years. Worldwide such quality is determined according compliance with the requirements by all interested users of accounting information. Among the main problems of improving the quality of financial accounting reporting in Russia are distrust of its content for the users and inadequacy of its content to the requirements. In Russia, the economic reforms have identified the need to improve the quality of financial statements. As the content of reporting is generated in accordance with the same rules as for the tax needs, it becomes unclaimed because doesn't meet the principle of neutrality. This can be explained partly be the manner of its formation. It must be admitted that the Russian Accounting Standards (RAS) today only partially meet international requirements. As it was mentioned in the analytical report of the National Organization for Financial Accounting and Reporting Standards Foundation (NOFA, 2005) in Russia introduction of IFRS rules in Russia will have an impact on various areas of accounting reports quality and government regulation. The nature of these effects depends on the legal mechanisms by which the rules of IFRS are introduced into the legal system of the Russian Federation. Analysis of the expected impact of IFRS implementation suggests that the application of the rules of IFRS doesn't have a negative impact on the accounting reporting quality, and in many cases, it will have a positive impact not only on the financial accounting, but on the managerial one, as well.

### **4. CONSLUSION**

The impact of globalization on developing countries is contradictory: on the one hand, it facilitates the integration of the world, but on the other - it turns out, tends to weaken the local specifics and trends to the local way of life, as Western cultural standards become dominant. Competitiveness in the context of globalization is directly dependent on the quality and transparency of corporate management and the level of development of its standardization. Effectiveness of the system inside standardization becomes an important competitive factor. Thus, considering the activities of the international company, it is necessary first of all to consider the impact of globalization on the processes associated with risk management and system of internal control. In the analyzed case of Russia, as a developing country, there are some further steps towards harmonization with the global impact on accounting. In particular, the new Law “On Accounting” was adopted from 2013. According to it, the main changes relate to the following issues (Table 3):



*Table 3. Main changes in new Federal Law “On Accounting” in Russia.*

1. Enterprises that are required to keep accounting	All, without exceptions, including private entrepreneurs
2. Methods of accounting organizing, including:	
- Requirements for managers,  - Requirements for chief accountants,  - Resolution of the disputes between managers and chief accountants	- responsibility for internal control added - requirement of higher professional education - transposition of the sole responsibility to the manager
3. Accounting policies adopted	- the possibility of independent developing of an accounting method in the absence of suitable one
4. Accounting documents	- the possibility of independent developing of an accounting method in the absence of suitable one - the possibility of complying in electronic form
5. Accounting reports and internal control	- only annual reporting is presenting for administrative users - now includes the possibility of explanation and disclosure

By looking at the experience of other developing countries, there is also some positive experience in this direction, for example, in Korea (KASB, 2013), that can be summarized as follows:

1. Setting need for education and promotion
2. Awareness of the importance of communication among local and foreign constituents
3. Providing a support for new IFRS adopters
4. Strengthening the role of the IFRS IC.

No less interesting is the experience of Ghana in IFRS implementation Antwi Kofi Gyashi, (2010) strengthens the main problems; some of them are the following:

1. Outdated terminology and practices
2. Accounting policy disclosures were missing or exceedingly inadequate
3. Some required disclosures in consolidated financial statements were not provided
4. Reported related party transactions failed to provide required detailed information (pricing policies, volume of transactions, nature of relationship, and outstanding items)
5. Not providing the information relating to deferred tax assets
6. No reconciliation to main statements were provided in reporting, etc.

All these cases should proceed from the understanding the fact that business activity, ex ante, is a complicated process with a high degree of uncertainty. It involves a multitude of actors, different types of resources and means of production. In such circumstances, high cognitive value has modelling as a method of study. Modelling in accounting allows establishing causal relationships between events, to evaluate and predict the future performance of the system

development. Under these conditions, the revealing of the dialectical relationship of the global information economy with the global changes in the theory and practice of accounting is required. The approach to minimize the situation models opens up prospects for the use of situation-matrix accounting in transition to IFRS process, since in this way - depending on the minimum set of input values can be set (via the general ledger), situationally by specific summary of matrix formulae and balance sheets.

The intelligibility of accounting technology presented as transformations of the initial formula of accounting data is provided by three factors:

1. The matrix model is valid for all kind of initial data and in any accounting system based on double entry.
2. Everything is reduced to familiar mathematical transformations of the initial data which are presented as a formula from the very beginning.
3. The formulae and their transformations are easily visible and can be logically reproduced due to uniformity and compactness of mathematical apparatus of matrix algebra.

Concerning the fact that for the large company reporting on IFRS requires 3-5 specialists in this area (staff with the ACCA or CPA certificate) and taking into account that the number of the companies adopting IFRS increases, it is obvious that in order to meet their needs in Russia, even today there should be more than 7000 staff. Even now there are about 50% of accountants who are aware of IFRS. Besides, the percent of companies that use IFRS is still not very high (not more than 20%). Thus, there is a certain need for IFRS-training among the accountants which will increase in case of the mandatory transition to IFRS. In such circumstances, Russian financial accounting needs can be served in, at least, 5-7 years. That is the time that it will take to bring the IFRS-training in accordance to the existing demand. As part of the emerging strategic approach to accounting, analysis, planning is becomes necessary to include in the financial statements not only indicators characterizing the financial position and results of operations, but also non-financial information, for example, the risks of non-compliance and the quality of economic security, social events, the application of energy-saving technologies, etc. This all requires the development of evaluation methods for such objects of new accounts as intellectual capital, customer base, developing methods for calculation of the innovative products cost. Accounting systems in developing countries face challenges for integrating of different accounting types: management, tax, social, environmental, etc. Along with the account and analysis of historical fact of economic life functions accountant analyst is enhanced by the formation and preparation of forecast information on future financial results and developments businesses. In such circumstances this work therefore offers the prospect of a thorough analysis of the influence of the considered effects on the quality of financial reporting in developing countries, as well as studying the changes of the users of accounting information needs in response to the occurring processes in accounting. With the aim to help the developing countries meet the requirements of external users worldwide. Russia continues adopting key principles of IFRS and, even now, the forms of accounting reports become more informative and the most attention in them is given to the priority of content over the form. Besides, the innovations in the accounting legislation in Russia tend towards the involvement in this process all the enterprises without exceptions. As it follows from the problems of harmonization of accounting standards it seems to be necessary to move in the direction of creating accounting meta-models which are compact and universe and which are invariant to the initial accounting data but easily adaptable to the existing national accounting systems in all their diversity. One of the effective tools of creating such meta-models is mathematic modeling, in particular the one which uses the basic notions and operations of matrix algebra. Concerning the fact that for the large company reporting on IFRS requires 3-5 specialists in this area (staff with the ACCA or CPA certificate) and taking into account that the number of the companies adopting IFRS increases,

it is obvious that in order to meet their needs in Russia, even today there should be more than 7000 staff. Even now there are about 50% of accountants who are aware of IFRS. Besides, the percent of companies that use IFRS is still not very high (not more than 20%). Thus, there is a certain need for IFRS-training among the accountants which will increase in case of the mandatory transition to IFRS. In such circumstances, Russian financial accounting needs can be served in, at least, 5-7 years. That is the time that it will take to bring the IFRS-training in accordance to the existing demand.

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## HAS THE IMPLEMENTATION OF THE ONE-STOP-SHOP (POINT OF SINGLE CONTACT) ENABLED SIMPLIFICATION OF THE CROATIAN ADMINISTRATIVE PROCEDURE TO INCREASE THE EFFICIENCY OF PUBLIC ADMINISTRATION?

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### **ABSTRACT**

*Through the public administration reform and under the influence of the processes of Europeanization, modernization, harmonization and transposition of numerous institutes of European Administrative Law, the Point of Single Contact has been introduced in the Croatian General Administrative Procedure Act 2009. The author, therefore, plans to show the development of the aforementioned administrative instrument since the initial stages of it being introduced into the Croatian Administrative Procedure in accordance with the General Administrative Procedure Act Proposal and Final Proposal of the General Administrative Procedure Act. Teleological, grammatical and logical interpretation methods will be used to analyze provisions of General Administrative Procedure Act regulating the institute of Point of Single Contact. Relevant provisions of the Treaty on European Union, Directive on Services in the Internal Market and the Charter of Fundamental Rights of the European Union will also be outlined. Special attention will be given to examining the impact of this model in promoting and enhancing the efficiency of public administration with the intention of providing better quality of communication and services to citizens. Furthermore, the implications of its application in practice will be examined. The paper will also describe the advantages and disadvantages that arise from applying the one-stop-shop principle, as well as the challenges and difficulties that the Croatian Administrative System has encountered in implementing this administrative instrument. The author specifically emphasises the importance of continuous monitoring of progress as well as examples of good practice of other European Union member states applying the one-stop-shop model. To illustrate the above, a Hungarian example of “Government Windows” will be briefly mentioned.*

**Keywords:** *administrative action, efficiency, General Administrative Procedure Act, Point of Single Contact, simplification*

### **1. INTRODUCTION**

Administrative Procedural Law operates as an important link in the functioning and modernization of the public administration, however, first and foremost it works as a means for conducting public policies while at the same time ensuring international and constitutional guarantees. The Administrative Procedural Law in the EU countries has, so far, been subjected to many changes and adaptations. Diverse influences and “pressure” has led to it being transformed in such a manner that it completely abandons traditional concepts. This was mostly visible in transitional countries through the public administration reforms and under the influence of the processes of Europeanisation and harmonization. In those countries, there was a tendency of continuous and dynamic growth present, as well as constant struggle to fulfil all the complex tasks of adjusting and implementing the European Law for the purposes of joining the EU and the necessity of changes with the aim of enhancing capacities for the transposition of numerous procedural law instruments. No matter the national autonomy, the demands for equality and efficiency have significantly influenced the national procedural laws and procedures.

To redefine the Croatian tradition and form it in a way it reflects the European administrative-procedural standards and examples of good practice, there was a progressive expansion of the content for the regulation of the administrative procedure. This paper, therefore, focuses on analyzing the Point of Single Contact introduced in 2009 in the Croatian legislative system as a direct result of the previously mentioned processes. The introductory part of the paper emphasizes the introduction of the Point of Single Contact in the Croatian Administrative Procedure by implementing the General Administrative Procedure Act in 2009 <sup>1</sup>(hereinafter: GAPA). The author plans to show the development of the Croatian Administrative Procedure from its initial stages in accordance with the General Administrative Procedure Act Proposal to the Final Proposal of the General Administrative Procedure Act. The instrument has been proposed in order to enable better cooperation and dialogue between the citizens and administration, as well as to simplify the administrative proceedings. The implications of its application in practice will be examined along with the short review of this model regarding its ability to promote and enhance the efficiency of public administration with the intention of providing better quality of communication and services to citizens. Furthermore, the paper will also point out all the advantages and disadvantages that arise from applying the one-stop-shop principle, as well as the challenges and difficulties that the Croatian Administrative System has encountered while implementing this administrative instrument. Finally, the author will present key conclusions regarding the presented subject matter.

## **2. THE INTRODUCTION OF THE POINT OF SINGLE CONTACT BY IMPLEMENTING THE GENERAL ADMINISTRATIVE PROCEDURE FROM 2009 THROUGH THE PUBLIC ADMINISTRATION REFORM**

### **2.1. European influence on the administrative procedure regulations with the emphasis on Point of Single Contact principle**

Thorough reform of the Administrative Procedure Act was needed not only due to it being obsolete, but also because of the European standards of the public administration, good practice of the EU countries, broadly accepted efforts oriented toward simplification, improvement and establishing of the new EU standards, along with strong information-communication technologies development.<sup>2</sup> Even though the Administrative Procedure Act was introduced in 2009 thus creating basic conditions for the development of the new administrative procedural law, the reform, however, was not complete. Numerous additional organizational, functional and personal changes had to be introduced in order to be able to implement the new institutes and allow them to properly function within our system. The necessity for administrative procedure regulations and introduction of the minimal guarantees and standards rose from the fact that procedural inequalities occurred in different EU countries regarding their legal resolutions. Due to given facts, the Directive on Services in the Internal EU Market from 2006 (hereinafter: Directive)<sup>3</sup> became extremely influential with regard to regulating and modernizing administrative proceedings. In March 2007 the European Council described the Directive as a significant “key” for unlocking the potentials of the European service sector and pointed out the necessity for prioritizing wholesome, purposeful and timely transposition of its regulations within the national legislations in a consecutive manner.<sup>4</sup>

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<sup>1</sup> Official Gazette, No. 47/2009. Entered into force on 1 January 2010.

<sup>2</sup> *Proposal of the General Administrative Procedure Act*, P.Z.E. No. 168, p. 1. Retrieved 28.3.2018 from file:///C:/Users/Laptop/AppData/Local/Packages/Microsoft.MicrosoftEdge\_8wekyb3d8bbwe/TempState/Downloads/PZE\_168.pdf (hereinafter: Proposal of GAPA).

<sup>3</sup> *Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market*, 32006L0123, Official Journal of European Union 376, 27 December 2006, p. 36–68 (hereinafter: Directive). Retrieved 28.3.2018 from <http://eur-lex.europa.eu/legal-content/HR/TXT/?uri=CELEX:32006L0123>

<sup>4</sup> See more in *Handbook on Implementation of the Services Directive*. (2007). Directorate General for Internal Market and Services, Luxembourg: Office for Official Publications of the EU Communities (Publications Office), p. 4. [http://ec.europa.eu/internal\\_market/services/services-dir/index\\_en.htm](http://ec.europa.eu/internal_market/services/services-dir/index_en.htm)

The important role was assigned to the Charter of Fundamental Rights of the European Union<sup>5</sup> which in the Art. 41 guarantee the right to good management in correlation with Art. 47.<sup>6</sup> Court of Justice of the European Union has “absolved” the legal principles and conceptual “tools” of the national legal systems including minor adjustments and changes. Furthermore, another great influence on applying administrative procedure comes from the European Administrative Procedural Law from which the European Administrative Procedure<sup>7</sup> has been formed. The Directive represents a highly ambitious and demanding project whose aim is to entice cross-border services and to modernize administrative structures and procedures within the EU countries (Möller, 2008, p. 351). The implications which the Directive has on the administrative procedural law refer to making a great effort for its simplification,<sup>8</sup> applying measures designed through the concept of administrative collaboration<sup>9</sup> and finally forming and applying the Point of Single Contact principle<sup>10</sup> (hereinafter: PSC). The demands were set for easy access to information, ensuring the procedures and formality when not communicating in person for example per e-mail (Art. 5-8 of the directive). The demands are basically formed to reform the system which has so far been overcrowded, complicated and slow, resulting in problematic procedures when forming businesses<sup>11</sup> focused on providing services.<sup>12</sup> Enticing mutual collaboration, exchanging information and examples of good practice is also to be pointed out. The EU countries had to re-examine all the procedures applicable when offering and providing public services. The countries were given a certain degree of freedom in the process of organizing PSC such as: organization, number and type of services, assigning functions, category of users, financing, whether they will be formed only electronically or also as a physical point of contact without questioning the jurisdiction between the legislative bodies. Four main steps are to be emphasized when forming PSC (Koprić, 2017, p. 2). They can be used only as a coordination, while the decisions are made by the assigned bodies with proper jurisdiction. One of the most important advantages of PSC is that they provide their users with a clear structure of the steps necessary for a particular action. They also offer support and information about the current procedures, as well as the timely frame of procedures, that is

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<sup>5</sup> Official Journal of the European Union, C 202, 7 June 2016, p. 389–405. Retrieved 26.3.2018 from [https://eur-lex.europa.eu/legal-content/HR/TXT/?uri=uriserv:OJ.C\\_.2016.202.01.0001.01.HRV&toc=OJ:C:2016:202:TOC#C\\_2016202HR.01004701](https://eur-lex.europa.eu/legal-content/HR/TXT/?uri=uriserv:OJ.C_.2016.202.01.0001.01.HRV&toc=OJ:C:2016:202:TOC#C_2016202HR.01004701)

<sup>6</sup> See Bodoriga-Vukobrat, N., Barić, S. (2002). *Charter of Fundamental Rights in the EU with comments*. Zagreb: Organizator. p. 75, 79-81.

<sup>7</sup> It represents the source of unwritten procedural rules formed in the EU countries, which are applied on EU material provisions. If the European dimension of the administrative procedures is being discussed, people usually rely on it being formed within the EU rights, but also through other dimensions such as the EU Council (its bodies, especially EU Court of Human Rights) including procedural guarantees of legal organization of the EU countries. More about this see Đerđa, D. (2012). *General Principles of the EU Administrative Law*, Rijeka: Faculty of Law, University of Rijeka, p. 146-160.

<sup>8</sup> Administrative simplification has become an important goal of the administrative reforms in many countries, and it has many forms. It refers to a series of measures, such as simplification of the legislation and reduction of legal provisions, simplification of administrative procedures, use of information-communication technology, applying the Point of Single Contact principle, reduction of the numbers of administrative bodies involved in a single administrative procedure etc. See more Koprić et al. (2014). *Administrative Science: Public Administration within the Modern EU Context*. Zagreb: Faculty of Law, p. 125.

<sup>9</sup> See also Art. 197 of the Treaty on the Functioning of the European Union, C 202, 7 June 2016. Retrieved 26.3.2018 from [https://eur-lex.europa.eu/legal-content/HR/TXT/?uri=uriserv:OJ.C\\_.2016.202.01.0001.01.HRV&toc=OJ:C:2016:202:TOC#C\\_2016202HR.01004701](https://eur-lex.europa.eu/legal-content/HR/TXT/?uri=uriserv:OJ.C_.2016.202.01.0001.01.HRV&toc=OJ:C:2016:202:TOC#C_2016202HR.01004701). Art. 20 of the Treaty on European Union, Official Journal of the European Union, C 202, 7 June 2016. Retrieved 26.3.2018 from [https://eur-lex.europa.eu/legal-content/HR/TXT/?uri=uriserv:OJ.C\\_.2016.202.01.0001.01.HRV&toc=OJ:C:2016:202:TOC#C\\_2016202HR.01001301](https://eur-lex.europa.eu/legal-content/HR/TXT/?uri=uriserv:OJ.C_.2016.202.01.0001.01.HRV&toc=OJ:C:2016:202:TOC#C_2016202HR.01001301). See Art. 25 (Chapter VII. Administrative Cooperation and Supervision) of the Services Act, Official Gazette, No. 80/2011.

<sup>10</sup> Art. 6 of the Directive describes how points of single contact have an important role in ensuring help for their beneficiaries functioning as bodies with jurisdiction necessary for providing legal documents in terms of services or as intermediaries between the service providers and legal bodies. Points of single contact do not necessarily have to be formed by administrative bodies but can also be created by chambers of commerce or chambers of trade and crafts, vocational organizations or private bodies entrusted by a member country with a particular role.

<sup>11</sup> The Directive is usually applied on all the services which are not excluded from it.

<sup>12</sup> One of the basic difficulties for small and medium sized entrepreneurship when providing their services is the complexity, length and legal uncertainty of the administrative procedures.



the official deadlines for starting and ending the procedures. Additionally, they are responsible for delivering notifications and responding to users` demands as quickly as possible. In accordance with the Directive the right to provide services within the boundaries of the Republic of Croatia is proscribed by the Services Act<sup>13</sup> (hereinafter: SA). PSC were established in the Croatian Chamber of Commerce based on Art. 6 of the SA. Finally, it is strictly legally regulated that all the procedures and conditions for providing services must be transparent, unbiased, easily accessible even per e-mail and regularly updated.

## **2.2. One Stop Shop according to the General Administrative Procedure Act from 2009**

The fundamental idea of forming the One Stop Shop (hereinafter: OSS) is taken from the business sector and is based on the principle that the user does not have to know, nor does he have to be burdened by the organization and difficulties occurring in the public administration: the user simply needs to be provided with the high quality administrative service quickly, efficiently and affordably (Koprić, 2017, p. 2). This institute was for the first time normed in the Croatian administrative law through the General Administrative Procedure Act in 2009.<sup>14</sup> The OSS institute is regarded as one of the most important instruments since it strengthens the public administration efficiency (Koprić, 2017, p. 10-15), especially with regard to its service-oriented feature intended for citizens, entrepreneurs and local community in a broader sense. Furthermore, the scope and quality of the administrative services have to be adjusted to the real needs of the users, while at the same time the procedure of providing the services should be simplified in a way that it demands the users` minimum involvement. Moreover, the quality of public services is to be improved as well as the modern information-communication technologies (hereinafter: ICT) all with the purpose of providing efficient service.<sup>15</sup> The general aim of the administrative service reform in accordance with the Croatian Strategy for the Development of Public Administration for the period from 2015 to 2020 represents improved public authorities (hereinafter: PA) procedures, whereas one of the special aims refers to enabling easier communication between legal service users and PA. The measure adequate for realizing the set aims is, therefore, forming of the OSS for the nearest citizens (organization plan, application production, change of regulations, ICT equipment, to train and qualify the staff, to entice citizens to use e-services, adjustment of services). The basic assumptions for forming OSS are the informatics-based connection of the PA and availability of central registers as well as preparation of applications based on simplified approach, which ultimately results in PA being internally well connected and coordinated<sup>16</sup>. In accordance with the Proposal of the GAPA it is stated that introducing legal basis for realization of the OSS principle was a significant novelty. Contact and coordination institutes are supposed to create legal assumptions for forming the OSS. The main purpose of the OSS is to enable the citizens to receive the solution of their matter by communicating with only one body in one place, which at the same time involves the proceedings of more than one PA. The initial proposal of the institute was regulated by Art. 26 where it was called “A single spot for the administrative procedure services (Single spot office)”. The institute was suggested within one legal article composed out of four paragraphs. However, there was also an alternative offering the possibility of deleting the mentioned article with the comment that the matter should be regulated in accordance with both the state administration organization regulations and local that is regional self-administration. Even though the PA has a duty of forming OSS, it is stated that “whenever the spatial and other conditions are fulfilled”, which can imply avoiding the commitment between the PA, although the process of forming OSS should be mutually agreed upon.

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<sup>13</sup> Official Gazette, No. 80/2011.

<sup>14</sup> See Art. 22 of the GAPA.

<sup>15</sup> *Croatian Strategy for the Development of Public Administration for the period from 2015 to 2020*, Official Gazette, No. 70/2015 (hereinafter: CS).

<sup>16</sup> See CS.

When compared with the Final Proposal of the GAPA, there are changes visible that refer to the institute's name and paragraphs within the Art. 22. That proposal is, in accordance with the Final Proposal of the GAPA, accepted in the currently effective GAPA. If more administrative procedures are needed, the user will be enabled to file all the necessary demands to the OSS which will then be delivered to the PA with proper jurisdiction. OSS can provide the users with forms, notifications, advice and other type of help. The Directive has enabled the introduction and legal verification of certain procedural motions within our administrative procedure. The principle of efficiency (Art. 10 of the GAPA) has allowed the administrative matters to be solved inexpensively without delay; the principle of information access and protection (Art. 11 of the GAPA) presents a logical extension to it. In accordance with the Art. 75 and 94 of the GAPA, the users are given the possibility to communicate electronically. Another novelty for the users is the right to be notified about all the conditions for realizing and protecting their rights (Art. 155 of the GAPA). Due to common objections of the citizens and business community referring to the length and complexity of the procedures, unclear jurisdiction of the assigned legislative body, necessity for diminishing the obstacles, ensuring availability, quality and speed of providing services, there is an obvious demand for fundamental and continuous change in the sense of simplification, redefining, improving and questioning administrative procedures. It is considered that the Croatian legislation has covered the most basic terms and has set grounds for forming the “new” GAPA, which need to be further developed and shaped in order to guarantee its full and successful functioning. However, some have been formed as only one legislative article, especially those regarding the OSS institute. The norming of this institute significant for both citizens and entrepreneurs is considered insufficient and unfinished with a lot of unclarities and defects. They particularly stand out when considering all the terms and assumptions set by the Directive as well as the freedom the member state has for forming the OSS, especially having in mind the use of the aforementioned model. Moreover, the European concept of administration being organized on multiple levels, including, of course, cooperation and communication which are vital for forming the OSS. The application of the concept should result with integrated public administration and services, which proves to be quite a challenging assignment. Proper use of the OSS principle and coordinated accompanying activities (organizational, communicational, legislative, functional and personal) ensure the promotion and adjustment of administrative model and can lead to effective performance.

### **3. SHORT REVIEW OF THE IMPLICATIONS OF THE ONE STOP SHOP PRINCIPLE IN CROATIAN ADMINISTRATIVE PRACTICE**

The electronic communication in Croatia, fundamental for the OSS principle, starts in the year 2000 when the Government Office for Internetization<sup>17</sup> was established. Based on the Decree on dissolution of the Internetization Office<sup>18</sup> in 2004, the Central State Office for e-Croatia takes over its business. Based on the Croatian Government decision on October 15<sup>th</sup>, 2004 started the project activities for OSS project. The system was conceived as a spot where citizens and entrepreneurs can quickly and effectively communicate with the state administration with the purpose of faster and easier investing and accessing the labor market. In 2014 it was therefore formed the OSS for entrepreneurs within the HITRO.HR network organized by the Financial Agency.<sup>19</sup> By reaching the Decision for Launching the e-Citizens project<sup>20</sup>, the Croatian government has started the project which since 2014 tries to enable the communication between the citizens and the public sector through portals which unify the information referring

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<sup>17</sup> Retrieved 15.4.2018 from <https://uprava.gov.hr/o-ministarstvu/ustrojstvo/uprava-za-modernizaciju-javne-uprave-e-hrvatska/arhiva-projekata/internetizacija-2000-2003/917>.

<sup>18</sup> Official Gazette, No. 2/2004

<sup>19</sup> Retrieved 10.4.2018 from <http://www.hitro.hr/Default.aspx>, <https://joinup.ec.europa.eu/document/hitrohr-croatian-one-stop-shop-hitrohr>.

<sup>20</sup> Official Gazette, No. 52/2013.

to the Government and Ministries as well as public services and therefore allow secure access to e-services by using electronic identity.<sup>21</sup> Establishment of electronic forms for implementing and solving the procedures is of utmost importance for expediting the procedures and excluding the administrative barriers. The important assumption for the OSS proper functioning is reliable electronic communication along with the clear user identification (Koprić, 2017, p. 6). In 2011 the Central State Office for e-Croatia and the Ministry of Public administration were unified in accordance with the assessment that better coordination of e-administration and other public administration processes is needed (Koprić, 2017, p.4). One of the particularly important projects of the Croatian Government is the OSS for citizens also known as *e-Citizens*,<sup>22</sup> which is available since June 10<sup>th</sup>, 2014. The system enables access to electronic services of the public administration by using a unique electronic identity. The development of the system is coordinated by the Ministry of Public administration with the assistance of numerous partners. The e-Citizens system consists of the Central Government Portal,<sup>23</sup> Personal User Mailbox (PUM)<sup>24</sup> and National Identification and Authentication System (NIAS).<sup>25</sup> The components provide secure and advanced communication with the public sector. The Republic of Croatia has formed the e-Citizens Contact Center functioning as a central contact and support spot for all current and potential users. Citizens are offered a wide range of electronic services (in the field of education, health, traffic and vehicles, finances and taxes, active citizenship, family etc.)<sup>26</sup> which significantly contributes to availability of certain services and at the same time to a simpler and quicker procedure of acquiring documents (both electronically and physically). The entire concept is viewed upon as being effective, successful and progressive. The number of users is constantly growing,<sup>27</sup> which indicates that the idea has been well accepted and recognized, while at the same time realizing its set purpose – to improve the efficiency of the public administration with the emphasis on improving communication and services intended for the citizens. Another thing to point out is the continuous progress in e-administration, particularly because basic conditions for providing e-services have been fulfilled (there is a difference between the e-services for citizens and for business subjects). Even though the e-services have becoming dominant in numerous areas, it is still necessary to connect the information systems more intensively. Conclusively, there is still a possibility for further improvement, development and growth of the system.

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<sup>21</sup> Retrieved 10.4.2018 from <http://www.uprava.hr/default.aspx?id=13899>.

<sup>22</sup> Retrieved 12.4.2018 from <https://pretinac.gov.hr/KorisnickiPretinac/eGradani.html>, <https://gov.hr/e-gradjani/23>. In 2015 it was described as the best on-going European project in the field “Open government for promoting public services”. Retrieved 12.4.2018 from <https://vlada.gov.hr/vijesti/projekt-e-gradjani-proglasen-najboljim-projektom-u-europi-na-podrucju-otvorena-vlast-za-unapredjenje-javnih-usluga/18015>.

<sup>23</sup> It handles the question of information and e-services dispersion. Ministry of Internal Affairs has made it possible to access all the electronic services by using an electronic identification card (eOI) with the identification certificate (the highest-level credential).

<sup>24</sup> This component allows the users to receive notifications from the public administration (more than 60 different notifications). Personal User Mailbox ensures proactive administration. It is available on mobile platforms iOS, WP and Android.

<sup>25</sup> NIAS is a unique e-identity verification spot enabling access to e-services. It functions as an information-technological solution for user identification and authentication on a national level (it allows various credentials of different security levels – from level 2 to 4). It plays a role of an intermediary between the e-service user, the e-service provider and the body issuing the credentials. See more *Strategy e-Croatia 2020*. (May 2017). Ministry of Public Administration, p. 26-27. Retrieved 15.4.2018 from

[https://uprava.gov.hr/UserDocsImages/Istaknute%20teme/e-Hrvatska/Strategija\\_e-Hrvatska\\_2020.pdf](https://uprava.gov.hr/UserDocsImages/Istaknute%20teme/e-Hrvatska/Strategija_e-Hrvatska_2020.pdf).

<sup>26</sup> For example some of them are e-services MIA, e-registry, e-taxes, e-newborn baby, e-print, e-construction permit, e-counselling and many other services. Retrieved 13.4.2018 from

<https://pretinac.gov.hr/KorisnickiPretinac/eGradani.html>.

<sup>27</sup> The number of users in municipalities see in

[https://gov.hr/UserDocsImages/Data%20za%20datagov.hr/MURHeGradjaniStat/I\\_ZupanijeEgradjani.xml](https://gov.hr/UserDocsImages/Data%20za%20datagov.hr/MURHeGradjaniStat/I_ZupanijeEgradjani.xml). 527 283-the number of unique users in e-citizens system, 767 698 the number of registered credentials within the e-citizens system (from June 1<sup>st</sup>, 2014 to March 1<sup>st</sup>, 2018). Retrieved 13.4.2018 from <http://data.gov.hr/dataset/e-gradjani-statistika>.

### 3.1. Challenges and difficulties encountered by the Croatian administrative system

Some of the challenges of introducing the OSS model as a tool enabling the opening of public administration to citizens in accordance with the changed role, values and expectations of citizens in order to contribute to the rationality and efficiency of the public administration system are reflected in the following:

- enabling greater electronic services availability, reducing administrative barriers and accelerating procedures, effective management;
- strategic and political approach / long-term support to the significance and advantages of this model, capacity building support, finding the balance between centralization and measures to achieve reform efforts and impacts;
- the appropriate normative framework (legal basis) that needs to be continually adapted, the necessity of educating civil servants, increasing the speed, availability and quality of services, reducing costs and saving time;
- the question of recognition and use of services through the PSC, the inability to perform actions and procedures only in electronic form, the promotion of transparency through communication;
- transparency, availability and simplification of information, giving citizens information related to the silence of administration, the issue of cooperation and coordination between different levels and bodies;
- fear of the public for information security and personal data protection, secure exchange of data, strengthening of informatics literacy skills both for the users and the service providers

## 4. CONCLUSION

One Stop Shops are physical or virtual places where business and citizens can obtain information and/or process different transactions related to their query. They aim to save time and costs for users by providing a single point of contact with the administration and reducing the number of transactions. Some one stop shops allow business or citizens to deal with all their administrative formalities in one place, others only provide information. Administrative simplification is long-term and continuous process whose results must be visible to the public service users. One of the political aims of most countries is to ensure the administrative simplification and it represents one of the most efficient methods in fighting the regulatory complexity, tediousness of the administration and numerous administrative difficulties. Some of the problems that many public administrations of the member countries are currently facing are: lack of political support and determination for change, lack of co-ordination and wholesome strategy for administrative simplification, lack of information, personal skills, knowledge and abilities (education of officials), lack of surveillance mechanisms (assessment) and procedure standardization, resistance to changes (novelties), limited resources availability, legal complexity etc. There is, however, no available model “one solution suits everyone” since each system has specific features determining it. The administrative dimension of the OSS is evaluated according to its openness, availability, procedural simplicity and transparency when providing administrative services, which ultimately leads to effectiveness and efficiency of the system. A good example of functioning of PSC model can be found in Hungary<sup>28</sup>-key objective of the reform was to build a system of client-focused public administration which resulted in the establishment of government-integrated one-stop-shop customer service centers called Government Windows (Kormányablak).<sup>29</sup> There are currently more than 2000 nation-wide.

<sup>28</sup> Retrieved 18.4.2018 from <https://magyarorszag.hu/>, <http://eugo.gov.hu/>.

<sup>29</sup> In 2011, integrated service contact centers or one-stop shops (“Government Windows”) started to operate as front offices of the Government Offices. They dealt with 30 different types of public administrative procedures and their task portfolio is constantly broadening. At the central government level main actors (practically all affected ministries were involved in the planning process) are the Ministry of Public Administration and Justice.

The first 29 Government Windows were opened on 3 January 2011 in county towns, county-level towns, in Budapest and Pest County. An important aim was to offer business and customer-friendly services. The Government Windows portfolio is being expanded all the time and is eventually expected to cover the entire public sector.<sup>30</sup> Introducing the OSS model into the Croatian GAPA for the first time in 2009, was a well-chosen legislative solution. Without its proper functioning, it, however, becomes useless, along with fulfilling the basic propositions in accordance with the Directive. Furthermore, the Croatian example has shown that a lot of effort has been put into the process of improving the services which the citizens can now use electronically, especially the project e-Citizens. This has simultaneously enabled saving time and expenses, as well as constant availability of the needed services and documents. In addition, the procedures have themselves become more simplified. There is. However, room for further improvement regarding the citizens being adequately informed, more frequent use of the electronic communication and equipment, reassuring the citizens with respect to the data protection, but also, better staff education, who are responsible for ensuring that the citizens use one place to submit their enquiries and function as a “personal user mailbox / personal user entrance / personal banker”. Despite all this, there are still cases where citizens are asked for their documents or credentials that PA should have the official access to, which is something to be avoided for future reference.

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## DIFFICULTIES IN PROCEDURE OF OBTAINING EVIDENCE ON MONEY LAUNDERING THROUGH CRYPTOCURRENCIES AS A POSSIBLE THREAT TO THE MARKET STABILITY

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### ABSTRACT

*Cryptocurrency is global phenomena of today, but can become the prevailing currency of the future. Bitcoin, as the most common type of cryptocurrency, is a decentralized digital money system, developed by an open community that uses it. Bitcoins are part of financial activities directly connected to IT sector, but due to the challenges they have recently caused they became the subject of legislative interest. The greatest problem of cryptocurrencies is the lack of specific legal regulation. The national legislation of the Federation of Bosnia and Herzegovina on prevention of money laundering did not include virtual money as a potential means of money laundering yet. When something is not regulated it is the opportunity for frauds and other malversations. The authors elaborate procedures of obtaining the evidences on money laundering and point out future challenges and difficulties of possible money laundering throughout the cryptocurrencies on national and international level. They emphasize the role of the insurance industry in recognition of cryptocurrencies as the new industry and part of financial market. Whether they will be part of future business or not the cryptocurrencies have already attracted enough attention to require the necessity to become the part of specific legal regulation.*

**Keywords:** *bitcoin, cryptocurrency, legal regulation, market stability, money laundering*

### 1. INTRODUCTION

A virtual currency is a type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community (Virtual Currency Schems, 2012., p. 13.). As of now virtual currencies in Federation of Bosnia and Herzegovina are in a legal grey area. We couldn't find any laws or regulations that would explicitly make them illegal. For the time being, cryptocurrencies. Bitcoin<sup>1</sup> as the most famous type is randomly mentioned on the web or in reports of some organizations. For that reason, most references in this paper are informal web sources, online magazine articles, e-books, reports and communications of public authorities and institutions. The cryptocurrency system enables payments to be sent between users without passing through a central authority, such as a bank or payment gateway. In order to preserve bitcoin, a digital wallet is required before purchase. Bitcoins are kept in it. A digital wallet is an application that can be installed on a cell phone, laptop, tablet or computer. Bitcoin, like all cryptocurrencies, relies on a technology called blockchain that makes its transactions so secure that experts consider them to be virtually unhackable. Every time a person makes a transaction using a cryptocurrency — for example, using funds stored in his or her crypto wallet to send bitcoin to someone else —

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<sup>1</sup> The idea for Bitcoin was first published in Satoshi Nakamoto's White Paper *Bitcoin: A Peer-to-Peer Electronic Cash System* in 2009. Since then, online communities have embraced the currency.  
<https://cs.stanford.edu/people/eroberts/cs181/projects/2010-11/Bitcoins/what-bitcoin-is.html>

the transaction is recorded on a digital ledger called a blockchain (Sabin).<sup>2</sup> Due to the lack of intermediaries and anonymity, bitcoin transactions are suitable for any form of money laundering, drug trafficking, and terrorist financing, and should therefore be further processed and regulated by law. Trough next chapters we will point out most challenging questions about cryptocurrencies and their impact on money laundering as well as the roll of insurance like a mean of anty-money laundering measure.

## 2. ANTY-MONEY LAUNDERING MECHANISMS AND REGULATIONS

Money laundering is a process that seeks to find the trace of the real source of unlawfully acquired money, exploiting financially and increasingly the non-financial sector and profession.<sup>3</sup> Money laundering as a criminal offense is regulated within the Criminal Code of the Federation of Bosnia and Herzegovina in the way that whoever accepts, exchanges, keeps, disposes of, uses in commercial or other business operations, the money or some other property for which he is familiar that was acquired through the perpetration of a criminal offence, or performs its conversion or transfer or otherwise conceals or attempts to conceal its nature, origin, location, disposal, movement, ownership or another right, and such money or assets representing the proceeds of crime were acquired by the perpetration of a criminal offence (Kazneni zakon Federacije Bosne i Hercegovine, article 272<sup>4</sup>): a) abroad or throughout the territory of Bosnia and Herzegovina or in the territory of the two Entities or on the territory of one Entity and Brčko District of Bosnia and Herzegovina or b) which is prescribed by the Criminal Code of Bosnia and Herzegovina or other state level legislation (Kazneni zakon Bosne i Hercegovine, article 209<sup>5</sup>). If a virtual currency is a type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community (Virtual Currency Schems, 2012) is it possible to treat it as a kind of money regulated in previous criminal code provision? The court found that bitcoins acted as money or funds as they were accepted to purchase goods and services from specific vendors (Anning et al., 2015, p. 4236<sup>6</sup>). There are several anty-money laundering documents of European Union that directly or indirectly could be applied. Convention on laundering, search, seizure and confiscation of the proceeds from crime (1990.), Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, Guidance for a Risk-Based Approach to Virtual Currencies (June 2015). Providers engaged in exchange services between virtual currencies and fiat currencies (that is to say coins and banknotes that are designated as legal tender and electronic money, of a country, accepted as a medium of exchange in the issuing country ) as well as custodian wallet providers are under no European Union obligation to identify suspicious activity. Therefore, terrorist groups may be able to transfer money into the European Union financial system or within virtual currency networks by concealing transfers or by benefiting from a certain degree of anonymity on those platforms.

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<sup>2</sup> Sabin, Dyani Everything You Need to Know About Cryptocurrency And Why It's The Future Of Money  
<https://futurism.com/cryptocurrency-future-money-bitcoin/amp/>

<sup>3</sup> Cindori, S.: Sustav sprječavanja pranja novca, Financijska teorija i praksa 31 (1), 2007. , str. 56.

<sup>4</sup> Službene novine FBiH 36/03, 37/03, 21/04, 69/04, 18/05, 42/10, 42/11, 59/14 i 76/14, 46/16, 75/17.

<sup>5</sup> Službeni glasnik Bosne i Hercegovine broj 3/03, 32/03, 37/03, 54/04, 61/04, 30/05, 53/06, 55/06, 32/07, 8/10, 47/14, 22/15, 40/15.

<sup>6</sup> Case SEC v. Shavers was launched in the federal court for the Eastern District of Texas in response to the defendant's fraudulent business.



It is therefore essential to extend the scope of Directive (EU) 2015/849 so as to include providers engaged in exchange services between virtual currencies and fiat currencies as well as custodian wallet providers (European Parliament legislative resolution of 19 April 2018 on the proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC (COM(2016)0450 – C8-0265/2016 – 2016/0208(COD<sup>7</sup>)). For the purposes of anti-money laundering and countering the financing of terrorism, competent authorities should be able, through obliged entities, to monitor the use of virtual currencies. Such monitoring would provide a balanced and proportional approach, safeguarding technical advances and the high degree of transparency attained in the field of alternative finance and social entrepreneurship (European Parliament legislative resolution of 19 April 2018).

### **3. LAW ON MONEY LAUNDERING PREVENTION AND TERRORIST FINANCING OF BOSNIA AND HERZEGOVINA**

The Law on Prevention of Money Laundering and Financing of Terrorism<sup>8</sup> was adopted at the level of Bosnia and Herzegovina. This regulation does not explicitly define in any article a cryptomarket or cryptocurrency. Nevertheless, by stipulating an obligation to credit and financial institutions, including money-transmission companies (hereinafter referred to as: payment and billing service providers), to collect accurate and complete data on the payer and include them in a form or message that tracks electronic money transfer, sent or received in any currency, it indirectly enables the means and the obligation to control transactions in cryptocurrencies market. In doing so, these data must accompany the transfer every time they pass the payment chain (art. 31 Zakon o sprječavanju pranja novca i financiranja terorističkih aktivnosti). The payment and billing service provider is required to collect accurate and complete information about payer and include them in a form or a message that tracks the electronic transfer of funds sent or received, regardless of currency, and these data must be tracked electronically throughout the payment chain, regardless of whether there are any brokers in the payment chain, regardless of their number (art.32 Zakon o sprječavanju pranja novca i financiranja terorističkih aktivnosti). Despite the existence of such superficial and indirect provisions, it is necessary to adopt explicit regulations and implementing regulations to control cryptocurrencies. According to the aforementioned provision, the collected data must be submitted to Financial intelligence unit-FOO. FOO is the central financial intelligence unit that receives, collects, records and analyzes data, information and documentation. The FOO investigates and transmits the results of the analysis and/or investigation, data, information and documentation to the competent prosecutors' offices, to the bodies investigating the criminal offense of Money Laundering and Financing of Terrorist Activities or other competent authorities in accordance with the provisions of this Law. The process of money laundering itself consists of three stages: placement, layering and integration<sup>9</sup> (Iljkić, 2015 p. 38; Reuter and Truman, 2004; The financial crimes Enforcement Network (FinCEN); Cindori, 2007, p.56). Virtual currency systems can be traded on the Internet, are generally characterized by non-face-to-face customer relationships, and may permit anonymous funding (cash funding or third-party

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<sup>7</sup> Text adopted Thursday, 19 April 2018 - Strasbourg, P8\_TA-PROV(2018)0178, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2018-0178+0+DOC+XML+V0//EN>

<sup>8</sup> Službeni glasnik Bosne i Hercegovine broj 47/14, 67/16.

<sup>9</sup> According to research of Brening et al. Economic analysis of cryptocurrency backed money laundering (Twenty-Third European Conference on Information Systems (ECIS), Münster, Germany, 2015) In the initial placement stage illicitly obtained funds are introduced into the financial system in a form or a place that is less suspicious to public authorities and convenient to make them more liquid. In the subsequent layering stage the funds usually get passed through many institutions and jurisdictions using multiple complex financial transactions in order to obfuscate their illegal origin and the integration stage integrates ill-gotten proceeds into the legal economy, where they appear to be legitimate, through financial or commercial operations

funding through virtual exchangers that do not properly identify the funding source (Guidance for a risk-based approach to virtual currencies, 2015., p.31).<sup>10</sup> In the realm of criminal law US v. Faiella is one of the first cases to address the nature of bitcoin as it applies to money transmitter and money laundering laws (Anning et al., 2015, p.4248). Also, an analysis published by the Financial Action Task Force (FATF) in June 2014 came to the conclusion that convertible virtual currencies may become a vehicle for AML/CFT activities (European Parliament Briefing, 2016<sup>11</sup>). Data obtained by OSA<sup>12</sup> indicate that members of the criminal milieu of Bosnia and Herzegovina are getting more and more money acquired illegally transferred via the virtual transactional system of Bitcoin – the cryptocurrency used in these transactions. Transactions between users are direct, without registered brokers (banks) and they are only registered in an online register called Blockchain. (Izvješće o stanju sigurnosti u Bosni i Hercegovini u 2016.<sup>13</sup>). It does not have an authorised central authority for money supply, nor a central clearing house, nor are financial institutions involved in the transactions, since users perform all these tasks themselves (Virtual Currency Schemes, 2012., p.6.). Because of all this, the need for more detailed legal regulation of transactions and transactions through cryptocurrencies is more than obvious.

#### 4. SPECIAL INVESTIGATIVE ACTIONS AS A MEANS OF EVIDENCE

If evidence cannot be obtained in another way or its obtaining would be accompanied by disproportional difficulties, special investigative measures may be ordered against a person against whom there are grounds for suspicion that he has committed or has along with other persons taken part in committing or is participating in the commission of an offense referred to in Article 117<sup>14</sup> of the Law on Criminal Procedure of Bosnia and Herzegovina. These special measures are as follows: a) surveillance and technical recording of telecommunications; b) access to the computer systems and computerized data processing; c) surveillance and technical recording of premises; d) covert following and technical recording of individuals, means of transport and objects related to them; e) use of undercover investigators and informants; f) simulated and controlled purchase of certain objects and simulated bribery; g) supervised transport and delivery of objects of criminal offense (art. 116.ZKP<sup>15</sup>). One of the ways of using Bitcoin in Bosnia and Herzegovina is to block the transactional accounts of legal entities by using computer programs, and then to unblock them, when money is being transferred through the Bitcoin system. Since transactions by bitcoin or any other virtual currency are treated like some form of cybercrime in Bosnia and Herzegovina, suitable measures for detecting, investigating and proving money laundering and other possible criminal offenses would be access to the computer systems and computerized data processing and in some cases surveillance and technical recording of telecommunications. Access to computer systems and computer data retrieval refers to comparing personal data of citizens that are processed into appropriate databases with the data and registers contained within the police records (Komentar

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<sup>10</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf>

<sup>11</sup> [http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/579110/EPRS\\_BRI\(2016\)579110\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/579110/EPRS_BRI(2016)579110_EN.pdf)

<sup>12</sup> BiH Intelligence - Security Agency is responsible for collecting intelligence related to threats against security of Bosnia and Herzegovina, not only inside, but also outside the State. Agency is responsible for analyzing of gathered information and providing it to authorized officials and bodies (highest authorities and its representatives), as well as collecting, analyzing and disseminating intelligence with aim to provide support to the authorized officials, as it is defined by the Criminal Code of Bosnia and Herzegovina, and to other relevant bodies in Bosnia and Herzegovina, when its necessary for repressing threats to security of Bosnia and Herzegovina. <http://www.osa-oba.gov.ba/nadle.html>

<sup>13</sup> <http://www.msb.gov.ba/PDF/info2017.pdf>

<sup>14</sup> Measures referred to in Paragraph 2 of Article 116 of this Code may be ordered for following criminal offenses: a) criminal offenses against the integrity of Bosnia and Herzegovina; b) criminal offenses against humanity and values protected under international law; c) criminal offenses of terrorism; d) criminal offenses for which, pursuant to the law, a prison sentence of three (3) years or more may be pronounced.

<sup>15</sup> Zakon o kaznenom postupku, Službeni glasnik Bosne i Hercegovine broj 3/03, 32/03, 36/03, 26/04, 63/04, 13/05, 48/05, 46/06, 76/06, 29/07, 32/07, 53/07, 76/07, 15/08, 58/08, 12/09, 16/09, 93/09, 72/13

Zakona o krivičnim/kaznenim postupcima u Bosni i Hercegovini, Zajednički projekt Vijeća Europe i Europske komisije, 2005., p. 355). Bitcoin transactions are also used for financing terrorists and that is the reason countries have to be very cautious<sup>16</sup>. According to the Information on the state of security in Bosnia and Herzegovina for 2016., the most common forms of cybercrime execution are: unauthorized access to the password and the use of the same without the permission of the actual owners, for the purpose of obtaining unlawful material gain or other benefits (misuse of information in order to discredit the owner or concealment of the actual author of information through other IP addresses ...); unauthorized prevention or interruption of access to the public network; creation and entry of computer viruses for the purpose of entering into a computer or a computer network or a telecommunications network; entering inaccurate or missing entries of accurate data or another way of influencing the result of electronic processing and transfer of data in order to obtain unlawful material gain; misuse of audio-visual content. Based on these data, existing legal regulations need to be extended to these potential ways of committing criminal offences.

## 5. CRYPTOCURRENCY INSURANCE

The rise of frauds and malversations connected to cryptocurrencies has resulted in insurance companies offering the new type of insurance - cryptocurrency insurance. The insurance ordinary follows the occurrence of specific risk. In other words, where there is risk, insurance follows (Rossiter, 2017).<sup>17</sup> Cryptocurrencies imply high risk and volatility. Their volatile valuations make them unsafe to rely on as a common means of payment and a stable store of value (Carstens, 2018, p. 9). The cryptocurrencies are much more volatile than bonds, stocks or other assets. To be safe one should invest in cryptocurrencies only if he/she can afford to lose invested money. So far only a few insurers sell cryptocurrencies insurance, including XL Catlin, Chubb, and Mitsui Sumitomo Insurance (Barlyn, 2018). The risks that this new type of insurance covers are frauds, cryptocurrency hacks, and technical errors. According to the Warning of the European financial authorities the cryptocurrencies currently available are digital representation of value that is neither issued nor guaranteed by a central bank or public authority and does not have the legal status of currency or money (Warning ESMA, EBA and EIOPA, 2018.). This is the main reason why public authorities and national central banks warn citizens not to invest in cryptocurrencies. Croatian Financial Stability Council and Croatian Central Bank have in 2017. issued public announcement that cryptocurrencies are not electronic money nor have legal status of currency according to Croatian legislation (Vijeće za financijsku stabilnost, 2017). At the beginning of this year the Central Bank of Bosnia and Herzegovina has also warn its citizens that cryptocurrencies are not covered with deposit insurance.<sup>18</sup> The most recent and famous cryptocurrency malversation and one of the biggest cyber theft is the Coincheck Cryptocurrency Hack in January 2018.<sup>19</sup> Hackers have stolen roughly 58 billion yen (\$532.60 million) from Tokyo-based cryptocurrency exchange Coincheck, raising questions about security and regulatory protection in the emerging market of digital assets (The Coincheck Cryptocurrency Hack: Everything You Need to Know, 2018). The attacked

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<sup>16</sup> According to The US Department of Justice , the FBI New York Joint Terrorism Task Force successfully intercepted Shahnaz after she fraudulently applied for over a dozen credit cards and obtained a loan for approximately \$22,500 under false pretenses. After converting illegally obtained money into bitcoin and other cryptocurrencies, Shahnaz is alleged to have wire-transferred over \$150,000 to individuals and apparent shell entities in Pakistan, China and Turkey.  
<https://www.occrp.org/en/27-ccwatch/cc-watch-briefs/7414-us-woman-arrested-for-funneling-funds-to-isis-using-bitcoin>

<sup>17</sup> See also: Bitcoin Exchange Guide, 2018

<sup>18</sup> See more: Centralna Banka BiH - Vijesti.ba/FENA (2018). Retrieved 22.04.2018. from <https://vijesti.ba/clanak/389130/o-kriptovalutama-se-potrebno-detajlno-informirati-ulozeni-novac-nije-osiguran>

<sup>19</sup> The impact on the cryptocurrency market is much smaller than the one caused by Mt. Gox theft given the immense increases in market capitalization since, though the dollar amount stolen from Coincheck is likely greater than the amount stolen from Mt. Gox in 2014 (pegged at \$340 million). See: De, 2018.

cryptocurrency was NEM<sup>20</sup> and this attack showed its vulnerability. The Coincheck have admitted that it has not used adequate security measures to store the stolen cryptocurrencies.<sup>21</sup> The Japanese Financial Services Agency (FSA) in January 2018. ordered improvements to operations at Tokyo-based Coincheck<sup>22</sup>, which suspended trading in all cryptocurrencies except Bitcoin after hackers stole 58 billion yen (\$534 million) of NEM coins<sup>23</sup>, among the most popular digital currencies in the world. This is to say that Bitcoins, as the world's most widely known cryptocurrency, are legally accepted as currency in Japan.<sup>24</sup> But the fact is that Bitcoin is also very risky to do business with. In favor of this statement goes the most recent Bitcoin related crime on Island known as “Big Bitcoin Heist” – the theft of almost \$ 2 million worth of cryptocurrency-mining equipment.<sup>25</sup> XL Catlin, Chubb, and Mitsui Sumitomo Insurance are insurance companies with cryptocurrency insurance in their portfolios offer. With Bitcoin and other cryptocurrencies recently exploding into the mainstream consciousness following an impressive run-up in the closing months of 2017, insurance companies are clamoring to lead the charge in insuring a largely uninsured market – and are willing to bet big on the unregulated market's future growth (James, 2018). This is to say that more and more insurance companies will offer this type of insurance. Mitsui Sumitomo Insurance is offering bitcoin exchanges around the world this new insurance policy since 2016. The policy for Mitsui covered losses related to external and internal threats and risks, or causes (Bitcoin Exchange Guide, 2018). Insurance companies have historically insured bitcoin businesses with one-off policies made specifically for them, and many exchanges were unable to find any insurance (Parker, 2017). This insurance covers theft risk, the loss from internal and external threats, including employee theft, mistakes, cyberattacks, and other unauthorized access. In the United States Bitcoin is classified as an asset, which means that it can be insured (EK Insurance, 2018). Bitcoin, as well as other cryptocurrencies, are deemed to be an intangible personal property.<sup>26</sup> Taking into account this legal nature of cryptocurrencies, the question arises as to which type of insurance covers them. In Canada goods – even virtual ones – are covered by home insurance, whether you're a homeowner, co-owner, or tenant (National Bank Insurance, 2017). In general, specifics of coverage vary depending on the company that is offering it. Thefts are usually covered but with limitations of maximum money that an insurer will pay per occurrence of the insured risk.<sup>27</sup> It is also covered only by insurance against all risks because cryptocurrency's theft is usually categorized as unexplained losses.<sup>28</sup> In addition to digital theft, cryptocurrency investors are also subject to technical errors, fraudulent exchanges, and other dangers – and very little protection exists for those who find their holdings have unexpectedly disappeared (James, 2018).

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<sup>20</sup> NEM is a cryptocurrency launched in March 2015 by a team of five developers.

<sup>21</sup> The Coincheck stored huge sum of NEM at „hot wallets“ and admitted its failure. See their public apology on their web site: *We would like to offer our sincerest apologies to our customers, other exchanges, and everyone else affected by the illicit transfer of NEM which occurred on our platform. We vow to take action on all of the points listed in the business improvement order handed down from the Financial Services Agency as we work towards resuming normal business operations. Currently, we have suspended various features on our platform including new registrations. Thank you for your patience and understanding.*

<sup>22</sup> Coincheck is a bitcoin wallet and exchange service headquartered in Tokyo (Japan). Coincheck started in 2014. and is operated by Coincheck Inc. See more: <https://coincheck.com/>

<sup>23</sup> The NEM coins were stored in a "hot wallet" instead of the more secure "cold wallet", which operates on platforms not directly connected to the internet, Coincheck said. It also does not use an extra layer of security known as a multi-signature system. See more: CNBC, 2018.

<sup>24</sup> The Central Bank of Bosnia and Herzegovina does not accept bitcoin as a currency and does not have any information about distribution of the market and the use of the virtual currencies in Bosnia and Herzegovina. See more: Centralna Banka BiH - Vijesti.ba/FENA, 2018. However, it is interested that International Monetary Fund has advised national central banks to accept cryptocurrencies as currencies and not to hinder development of new technologies and industries. See: Estevás, 2018.

<sup>25</sup> See more: Meyer, 2018.

<sup>26</sup> See more: Anning, 2015., loc. 3730.

<sup>27</sup> XL Catlin for example offers annual coverage of cryptocurrency theft up to \$ 25 million per claimed damage.

<sup>28</sup> See: National Bank Insurance, 2017.

Since insurance of cryptocurrencies is still undefined, its development is just following. The Great American Insurance Group, for example, only protects Bitcoin-accepting businesses from employee theft, but doesn't insure against hackers. Other companies will avoid insuring online wallets—commonly known as “hot wallets”—due to the increased risk of outside hackers (James, 2018). However, insurers who are willing to offer this type of insurance today will become recognizable in this area. This should bring them a profit. So, whoever risks today will profit tomorrow. Henry Sanderson of Lloyd's broker Safeonline LLP told Reuters: “If we don't embrace it now, it's a missed opportunity for insurers.” (Ganguanco, 2018). Bitcoin has now become a new class of asset that can be insured, and insurance companies like the fact that it can rise in value before being converted into actual currency, which means that the premium payments that are paid in virtual currency may be more in the future - if the currency is not converted immediately (EK Insurance, 2018). But, the result can be opposite. Risks related to cryptocurrencies are probably the largest since the insurance industry exists. However, some insurers don't even accept classification of the bitcoin as an asset (Hofrichter, 2018). Accordingly, they do not consider to offer cryptocurrency insurance at all. The trend is such that cryptocurrency insurance will become a new type of insurance if it is not considered so already. When it becomes globally represented thefts, hacker attacks and other frauds will become more controlled and more preventive measures will be involved through risk assessment. Even though cryptocurrency insurance means acceptance of cryptocurrency market and industry existence, this type of insurance should act preventively in money laundering appearance.

## 6. CONCLUSION

According to the Briefing of European Parliament there is currently no EU legislation on virtual currencies, which does not mean that they are completely unregulated in member states. In many Member States, nothing more than a series of opinions and warnings has been issued by central banks or regulators. Bosnia and Herzegovina, which is not part of the European Union, is one of the countries whose relevant institutions have issued warnings and various notices about risks related to cryptocurrencies. One remedy, as suggested in the US to avoid malversations by transactions through cryptocurrencies, may be not to shut down Bitcoin directly, but to apply the legal code requiring all money transmitters to have licenses for Bitcoin. Since Bitcoin does not have any particular central authority, the government could just require every node that operates in the U.S. to have a license, effectively rendering the use of Bitcoin illegal since presumably most individuals would be incapable of going through such an arduous process. The government may also consider enforcing this law at the exchanges from U.S. dollars to Bitcoins, however this may raise legal challenges considering that the money transmission does not technically occur at the point of exchange (Regulating Bitcoin). Since the Law on the Prevention of Money Laundering and the Financing of Terrorism also provides obligation for constant and regular vocational education, training and improvement of employees engaged in the prevention and detection of money laundering and financing of terrorist activities, education of practitioners in the fight against malversations through cryptocurrencies is indispensable necessity. The goal is to put the virtual currency exchange platform under the existing anti-money laundering directive especially the last resolution that amended the last Directive adopted this year. The trends in the measures taken and the indications of the next steps are: adopting a BiH strategy in the fight against high-tech crime; To improve cooperation with the private sector in combating computer crime through the development of treaty agreements; Raising awareness of the security of using IT technology; Education of Police Officers and Prosecutors on Contemporary High Technology Crime and their Trends, Modes and Forms (Information on the Security Situation in BiH). Since the EU Parliament has adopted the proposal of fifth directive, national legislations of EU member states

must, harmonize their legislations. Although Bosnia and Herzegovina is not a member of the European Union, but has formally applied for membership, it is necessary to align the legal framework with the EU *acquis communautaire*. However trading by cryptocurrencies is a form of uncontrolled cross-border business and transactions. BiH is not spared of this kind of transaction even though it officially does not treat bitcoin as legally recognized currency. The rise of frauds and malversations connected to cryptocurrencies has resulted in insurance companies offering cryptocurrency insurance as a new type of insurance. This insurance covers losses related to internal and external risks such as theft risk, employee theft, mistakes, cyberattacks, and other unauthorized access. Specifics of insurance coverage vary depending on the company that is offering it. Cryptocurrency insurance is still insufficiently defined. In Bosnia and Herzegovina cryptocurrency insurance is not regulated at all since cryptocurrency is not legal currency. However, Bitcoin has now become a new class of asset that can be insured and Bosnia and Herzegovina is not protected nor posted from cryptocurrency transactions and market. When cryptocurrencies became globally covered by the insurance, thefts, hacker attacks and other frauds will become more controlled and more preventive measures will be involved through risk assessment. Even though cryptocurrency insurance means acceptance of cryptocurrency market and industry as regulated one, we cannot deny the fact of their existence and we find that cryptocurrency insurance will act preventively in money laundering appearance. The fact that transactions with cryptocurrencies is not represented in BiH doesn't mean that there is no need to identify and regulate it by law and to define involved risks including money laundering. The fact that transactions with cryptocurrencies are not represented in Bosnia and Herzegovina that doesn't mean that there is no need to identify and regulate it by law and to define involved risks including money laundering.

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